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**MONTEREY, CALIFORNIA**

## **THESIS**

**GERMANY, EUROPE AND THE EURO CRISIS:  
ECONOMY, STATE AND SOCIETY IN THE PAST AND  
PRESENT**

by

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December 2013

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SOCIETY IN THE PAST AND PRESENT**

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## **ABSTRACT**

This thesis examines Germany's role at the center of the European Monetary Union (EMU). It explores German socio-economic policies and experiences in order to provide a more comprehensive understanding of why the EMU operates with German influence as well as in opposition to it. Historically, Germany's economic experience, from the Weimar Republic to 2013, has been uniquely shaped by its population and the embeddedness of its market place. From this experience, Germany has erected certain elements of government protection forged by a century of civil protection. These experiences also shape Germany's place in the Euro area as well as its policies toward the European economic crisis from 2007 through 2013. As of 2013, most Euro area members consider Germany as the economic backbone to the union, but rarely internalize Germany's economic past. Therefore, an application of the development of the German social market bears considerable importance upon the future of the Euro area as well as the policies enacted within the union, which Germany seeks to shape.

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## **LIST OF ACRONYMS AND ABBREVIATIONS**

CDP	Christian Democratic Party
CDU	Christian Democratic Union
DMO	German Debt Office
ECB	European Central Bank
EDP	Excessive Debt Procedure
EFSF	European Financial Stability Facility
EMU	European Monetary Union
EPU	European Payment Union
EU	European Union
FDP	Free Democratic Party
GDP	gross domestic product
IGO	intergovernmental organization
IMF	International Monetary Fund
MTO	medium term budgetary objective
O.E.E.C.	Organization for European Economic Cooperation
RM	Reichsmark
SCP	Stability and Convergence Programmes
SDP	Social Democratic Union
SS	Schutzstaffel
U.S.	United States

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## I. INTRODUCTION

The fate of Europe and its prosperity have long been an urgent security concern of the United States (U.S.). The crisis of the European common currency and the political efficacy of the European Union (EU) form a new chapter in the evolution of Europe from war to peace and now into a new crisis with security implications that cannot be ignored in a U.S. defense establishment focused on Asia. The European economic crisis—which began in 2007 and lingers into today—revealed that the currency union that underlies the European Union suffers from contradictions in need of serious consideration for restructuring and protection from shocks. The Euro area crisis highlighted particular weaknesses within the currency union to include undercapitalization of national banks, individual sovereign country debt burdens, and marginal economic growth.<sup>1</sup> In the landscape of the Euro area, such nations as Holland, Germany and Austria have performed relatively well, but they too have encountered a crisis that calls into question past and current policy decisions. Once more the fortunes and power of Germany as the power of Europe have emerged as central to the fate of Europe and its prosperity and security.

The research in this study will focus on the economic history of the Euro area, with a particular emphasis on the German role within it, as a means of understanding the roots of the current Euro crisis. Specifically, when compared to the European market the German market takes on both similar and divergent characteristics that formed the current paradigm. With regard to the foundations and sources of an economy in the social strata, the question of how does the German market and society differ from that of its European partners is pertinent to this research. Particular social protectionist measures in place in Germany, such as strong labor unions and universal banks, have delivered steady progress. Since 2000, Germany and Greece nearly sustained positive gross domestic product (GDP) annual growth rates every year until the financial crisis beginning in

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<sup>1</sup> Jay C. Shambaugh, Ricardo Reis, and Helene Rey, “The Euro’s Three Crises,” Brookings Institution, Brookings Papers on Economic Activity, Spring 2012, 162–170.

2007.<sup>2</sup> With Germany's GDP annual growth slightly below two percent and Greece's in excess of negative 7.5 percent in 2012, however, highlighted Germany's ability to perform due to its innate economic strength through crisis. The main hypothesis underpinning this thesis is that the stark differences seen between countries in the Euro area, especially between Germany and Greece and Italy, results from the inherent differences in the banking practices of each country, which are in turn the product of each country's socio-economic past.

Now a member of a transnational economic union, how has Germany found its place as the backbone of the Euro area? Its place in the Euro area is unique, and a deeper understanding of how Germany achieved this is imperative. Also, Germany's institutions are unique as well as a result of its economic and political history. How Germans have come to think about money and politics in specific ways as a result of depression and war has formed its trajectory within the European Union. In addition, the evolution and character of the state, economy and society in Central Europe and Southern Europe are essential elements to understand the present crisis in its detail.

#### **A. IMPORTANCE OF GERMANY WITHIN THE EURO AREA CRISIS**

On a global scale, the Euro area crisis has large-scale implications. Germany is the backbone of Europe, with its economic success being of great interest to it, its European neighbors, and the international community. In one sense, Germany is an integral part of the European economic system. Although Germany faces economic pitfalls, as described by Siebert, its ability to maintain its relative economic strength in Europe is paramount. Germany shares many of Europe's economic condition, however, "the German illness cannot be characterized as a pan-European disease."<sup>3</sup> Therefore, a specific look at Germany's economic history is necessary.

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<sup>2</sup> "Germany GDP Annual Growth Rate," Trading Economics, Accessed November 5, 2013, <http://www.tradingeconomics.com/germany/gdp-growth-annual>.

<sup>3</sup> Martin Feldstein, "Germany's Economic Ills," National Bureau of Economic Research, <http://www.nber.org/feldstein/siebert.html>.



Researching the causes and effects of the Euro area's financial crisis has become increasingly important as the world becomes more interconnected economically and socially. The current European malaise poses a challenge to theorists who believe that a globalized world results in prosperity. An alternative vantage point could reveal evidence that does not support this theory. A truly globalized world is one of international market interconnectedness and could mean the possible breakdown of local or regional social distinction, such as nation-states or certain ethnicities. This research does not suggest that the globalized world has truly taken form, or will, in Europe. In fact, the regional differences within Europe could explain the differing economic problems that face each country. The Euro area is made up of countries with individual unique institutions, with differing political-economic situations. Hence, although the Euro area provides a transnational umbrella that can lead to prosperity, each country brings its own problems and benefits to the common market. In looking at the embedded nature of economics in societal institutions, a greater grasp of the economic collapse could be achieved, which could force political-economists to reevaluate policy decisions in future situations.

## **B. PROBLEMS AND HYPOTHESES**

Through a historical lens, a comparative analysis of the Weimar Republic and current Germany sheds light upon political and economic decisions that have affected not only Germany but also the entire European economic union. In researching the causes and effects of economic and political decisions of German elites through history, it is important to understand no single element was at the core of any economic crisis discussed in this research; yet certain historical patterns are relevant to the current crisis. The research will pursue the following hypotheses and lines of inquiry.

First, the Weimar Republic presents a historical case study with many parallels to the more contemporary German social and economic situation. A guiding hypothesis of this work is that Germany's economic history sheds a great deal of light on the causes and effects of current German economic practices. The complexity of the economic crisis in Europe certainly requires more than a simple prescription. Yet a thorough analysis that weighs not only economic and political issues, but also examines the social dynamic

underpinning political-economic choices is necessary. The economic story of the Weimar Republic presents differing aspects to the current Euro area crisis, but certainly contains similar aspects as well.

Second, a retelling of Germany's economic history can help to correct common inaccuracies that policy makers abroad continue to maintain. Chronologically, from the Weimar Republic's economic crisis compounded by its vast war reparations to the rise in cartels and worker's leverage, a misreading of this history exists. A pendulum exists as well, and Karl Polanyi explained it to be one that swings from market forces to societal pushback. When society can no longer tolerate the rate of change and social dislocation imposed by the forces of the market it insists on protection, often in the form of government intervention in the market.<sup>4</sup> In the throes of war, German society endured difficult social and economic circumstances, which explains its government's policy decisions to erect institutions that protect its society. A core hypothesis motivating this study is that German policy decisions can be seen as having constructed a form of capitalism effectively tailored to German society, which can be contrasted to Anglo-Saxon capitalism. Moreover, among the differing forms of worldwide capitalism, and despite the heavy hand that the United States played in Germany's modern history, the German social market is inherently different from its Western capitalist counterparts. The evidence remains with Germany's cartel past, a divided country from hot wars to the Cold War, and the social market's unique makeup of industry, labor, and government.

Lastly, despite Germany's economic emergency, its economy is strong enough to weather the storm and maintain its prominence within the economic union as well as internationally. The hypothesis here is that Germany has continued to pursue economic policy geared toward a greater Europe while giving up sovereignty amidst battling individual sovereign ideals. Siebert wrote, "This trend is manifest in many policy areas, including monetary policy, subsidy control, and a large number of the regulations in the

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<sup>4</sup> Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Boston: Beacon Press, 2001), 138.

product market, the environmental arena, and the capital market.”<sup>5</sup> In exploring this hypothesis, this thesis will ask the question, what European-wide policy decisions mirror German policies, and what commonalities exist in the effects?

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<sup>5</sup> Horst Siebert, *The German Economy: Beyond the Social Market* (Princeton: Princeton University Press, 2005), 292.

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## **II. LITERATURE REVIEW**

In order to organize the historical information pertaining to Germany's economic history from the Weimar Republic to today, a framework must be established that highlights past and present studies of the subject. The following framework follows a chronological retelling of German economic history and establishes the recognized literature in this field. This literature review will establish essential themes in each era that, along a linear axis, fall between the two extremes of a central government controlled economy and one that is completely liberalized and free from government intervention. Therefore, along this linear axis, Germany ebbed and flowed from either extreme, but leaned toward the side of government intervention driven by protectionist measures versus an economic system completely free of government control. The review thus provides the necessary foundation for explaining the German socio-economic trajectory, and more importantly understanding the broader EU implications of German influence. This historical understanding of the development of the social market will in turn deliver a comprehensive study of the Euro area economic crisis through the lens of the German politician, employer, and laborer.

Generally, theoretical discussion on economic policy can be arrayed along a spectrum with two differing camps at the extremes of the framework. To the left are the proponents of government intervention to the extremes of Karl Marx, who preached a centrally planned state as a necessary step toward the communist utopia. To the right are those who believe in no government intervention in economic policy, and a state that only provides the infrastructure for the market to grow in the anarchic system, such as Adam Smith or Friedrich Hayek. This research will fall somewhere in between and explain Germany's economic history along the lines of Karl Polanyi, who suggested that a double movement exists that explains the dialectical nature of society and economic policy through history.

Polanyi explained the political and economic influences that created The Great War and the policies that ensued in the interwar period. Because economic institutions are embedded in society, Polanyi emphasized the increasing importance of national

currencies within the international system. Polanyi wrote, “Internally and externally alike, dwindling currencies spelled disruption.”<sup>6</sup> Furthermore, he rationalized that economic and political policies, due to their inherent interoperability, valued the social worth placed in the gold standard adhered to by many European countries and America, because of its tangibility. Great Britain, America, and France attempted to keep their currencies relevant to one another so to stave off inflation. Yet, Polanyi explained, “When the usual swing of the pendulum after seven years of prosperity brought the long overdue slump in 1929, matters were immeasurably aggravated by the existing state of cryptoinflation.”<sup>7</sup> Polanyi questioned the sole adherence to the market system, but did not advocate a strict planned economic system. In the case of Weimar Germany, Polanyi wrote, “Our thesis is that the idea of a self-adjusting market implied a stark utopia. Such an institution could not exist for any length of time without annihilating the human and natural substance of society.”<sup>8</sup> Again, the dialectical nature of society and economics determined the Weimar Republic’s history. Because society and the market act dialectically related to one another, the different social, economic, and political challenges that are specific to each country’s circumstances create unique forms of capitalism. With varying societies and economic needs, an understanding that “A market economy must comprise all elements of industry, including labor, land, and money,” is essential.<sup>9</sup> This literature review chronologically highlights core economic themes in contemporary German history and then turns more specifically to the European Union and its current financial crisis.

## **A. GERMAN ECONOMIC HISTORY**

Hardach portrayed a disgruntled German people during the Weimar years.<sup>10</sup> From the burden of reparations from World War I to deflation policy, the German government

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<sup>6</sup> Polanyi, *The Great Transformation*, 25.

<sup>7</sup> Ibid., 27.

<sup>8</sup> Ibid., 3.

<sup>9</sup> Ibid., 74.

<sup>10</sup> Karl Hardach, *The Political Economy of Germany in the Twentieth Century* (Berkeley: University of California Press, 1980)

under Heinrich Brüning was in the midst of a policy struggle to manage the financial security of its people and government. In hopes of promoting a stronger export base to strengthen Germany's economic presence, Brüning was forced to pursue an economic policy of deflation in order to remain relevant in the world economy, and not fall into "national isolation by means of reflationary measures."<sup>11</sup> Under Kurt von Schleicher, the German government focused on job creation and managed to have the Reichsbank fund much of the new policy.<sup>12</sup> The Schleicher government left office and Adolf Hitler's government moved in under the theme, "individual activity must never clash with the interests of the community, but must be carried out within the collective framework for the good of all."<sup>13</sup>

Wasserstein explained that there was no single cause of the Wall Street crash in the early 1930s. Indeed, the author singled out that "the return to the gold standard by Britain and most other major industrial powers" was a primary cause, but there were many others.<sup>14</sup> Much like the Great War, a single element cannot explain why the crash occurred, but Wasserstein included war reparations, the changes contained in the modernizing of industry, unemployment, and "weakness in the international monetary system and in the banking systems of Germany, Austria, and Hungary."<sup>15</sup> The weakened German economy fueled international speculation, which damaged its reputation and investment future. Like Karl Hardach, Wasserstein detailed Chancellor Brüning's deflationary policies that "raised taxes and introduced drastic cuts in government expenditure."<sup>16</sup> These tactics only worsened the economic situation and, in order to keep capital within Germany, banks had to limit transaction amounts, and Germans were unable to travel outside of the country.<sup>17</sup>

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<sup>11</sup> Ibid., 44–45.

<sup>12</sup> Ibid., 48.

<sup>13</sup> Ibid., 53.

<sup>14</sup> Bernard Wasserstein, *Barbarism and Civilization: A History of Europe in Our Time* (Oxford: Oxford University Press, 2007), 165–166.

<sup>15</sup> Ibid., 166.

<sup>16</sup> Ibid., 167.

<sup>17</sup> Ibid., 167.

Braun described a vibrant German economy after World War II. With strong growth stemming from its export business, Germany faced the problem of large cash inflows that threatened another inflation crisis. Although still very high, “The slower growth in the 1960s was mainly caused by a lower elasticity of the labour supply.”<sup>18</sup> The large labor supply transformed as workers aged and new ones encountered longer education cycles. The result of the declining labor force was an inflow of labor from Italy, Greece, and Spain.<sup>19</sup> Yet, Germany’s relatively strong growth can be attributed to the strong social dynamic of a German generation that witnessed depression and war in a condensed timeline. German growth was unique in that it capitalized on its current situation, and enabled an economic apparatus capable of leading through exports. Moreover, the short term growth experienced in the 1950s can be attributed to “Industry[‘s] react[ion] to this by introducing capital-intensive methods of production which increased output significantly.”<sup>20</sup> Certainly, the element of export led growth became a uniquely German experience and brought about relative short-term growth, but how the desired long-term growth would be achieved came into question.

Braun explained, furthermore, based on the experience of the unequal distribution of wealth and the belief that the failure was in private capitalism, German policy makers of the Social Democrats and the Christian Democrats advocated, “that the nationalism of key economic sectors would be more conducive to general welfare.”<sup>21</sup> Simply, strong distrust of liberal or neoclassical economic policy makers grew. Although skeptical, Social Democrats and Christian Democrats valued the market system’s method as necessary for growth that a planned economy could not produce. Braun’s description of a third way, one that protected the social dynamic of socialism and greeted the growth brought by the market, laid the foundation for the modern German social economic state. Protections were placed on the *Mittelstand* in order to fuel small and medium sized

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18 H.J. Braun, *German Economy in the Twentieth Century* (London: Routledge, 1990), 168.

19 Ibid., 169.

20 Ibid.

21 Ibid., 176.



business growth. In the market, a banning of cartels ensued, except in “agriculture, housing, transportation, banking, and insurance.”<sup>22</sup>

Sherman offered an account of the complex social, economic, and political issues posed the cusp of re-privatization upon German unification. Re-unification with East Germany brought about difficult social and economic repercussions—including differences in wages and living standards—that liberals believed could be answered by a freer market. The author detailed that East German living standards were high in comparison to other eastern bloc countries, but were still lower than West Germany’s.<sup>23</sup> In the midst of unification, the currency disparity between East and West Germany exacerbated the social factors of a common German people.<sup>24</sup> Moreover, upon unification came the currency adjustment period that drastically affected employment and standards of living through unified Germany. The currency adjustments offered by West Germany was one of many attempts to “soften the impact of ‘creative destruction’ on the population and to bridge financing for those firms which—after reorientation—may stay in business.”<sup>25</sup> Sherman’s work blended the social responses well against the fiscal measures taken by policy makers, and displayed the dialectical nature between the two.

## **B. GERMANY IN THE CREATION OF THE EUROPEAN ECONOMIC AND MONETARY UNION**

The creation of the European Economic and Monetary Union (EMU) was not a simple task for Germany, but Mertes argued that it was Helmut Kohl who understood the lasting implications of a common currency.<sup>26</sup> On an economic basis the Mark was strong, and Germans found it difficult to share a currency with neighboring countries. Mertes made a socio-political argument for Germany’s place of power and said, “[Kohl] personified predictability and reliability, which was good for Germany, a country that

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<sup>22</sup> Ibid., 180.

<sup>23</sup> Heidemarie C. Sherman, *German Unification and the International Economy*, eds Leonard Waverman and Bernard Heitger (Florence: Routledge, 1993), 5.

<sup>24</sup> Ibid., 7.

<sup>25</sup> Ibid., 17.

<sup>26</sup> Michael Mertes, “Helmut Kohl’s Legacy for Germany,” *The Washington Quarterly*, vol 25, no 4, Autumn 2002, 68.

more than any other in Europe depends on its neighbors' trust."<sup>27</sup> In German society Kohl was regarded with high esteem because he lowered inflation and created 2.2 million jobs between 1986 and 1990.<sup>28</sup> Even with the currency crisis during reunification in recent memory, Germany was the economic hegemon during the inception of the EMU in 1999.

Empirical evidence and policy decisions developed Germany's powerful position within the EMU. In his retelling of Euro's first decade, Dyson portrayed a skeptical Germany concerned "about whether the conditions for a 'stable' and 'strong' [E]uro were secure."<sup>29</sup> The author depicted a strong Germany that accounted for "27.5 per cent of total Euro Area GDP and 37.25 per cent of external trade in goods in 2006."<sup>30</sup> Furthermore, Dyson placed heavy emphasis on Germany's role in the creation of the EMU and its insistence on a rules based approach.<sup>31</sup> Yet, the author revealed a paradox of power created in the Bundesbank's new role. On one hand the bank lost its reason for being, but on the other it allowed German methods and ideals to be reflected in the newly created EMU.<sup>32</sup> The first decade of the Euro did not provide Germany with the overwhelming economic power that it wished for, but it allowed for strong years, such as 2003 to 2005, to develop. The strong years of the common Euro currency has given Germany leverage among its economic partners.

Siebert delivered a vivid account of Germany's economic progression in the years leading up to the Euro area financial crisis of 2007. Published in 2005, Siebert's explanation was apt in highlighting that "Germany has an institutional incentive system that has caused unemployment to ratchet upward in each recession, and negative economic shocks to last longer and be more severe each time."<sup>33</sup> Although Siebert argued

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<sup>27</sup> Ibid., 69.

<sup>28</sup> Ibid., 73.

<sup>29</sup> Kenneth Dyson, *Euro at Ten: Europeanization, Power, and Convergence* (Oxford: Oxford University Press, 2008), 132.

<sup>30</sup> Ibid., 133.

<sup>31</sup> Ibid., 136.

<sup>32</sup> Ibid., 139.

<sup>33</sup> Siebert, *The German Economy*, 377.

for a realignment of Germany's social policies, he did not believe that government intervention would solve economic crisis. Unlike the traditional economic thought of Germany, Siebert aligns more appropriately with Adam Smith in his interpretation of how the state must interact with the entrepreneur. Siebert's thesis is that "[Germany's] policy failures are linked to the priority that has been given to social protection and equity."<sup>34</sup> His thesis meshes with Wasserstein's interpretation of the Weimar Republic's economic crisis because of the overburden created by large social welfare programs. His neo-classical interpretation of the ensuing economic crisis placed blame upon Germany's restrained market economy that habitually sought government intervention instead of market self-correction, and that an "institutional big bang" must occur to lift Germany out of doomed recession.

### **C. THE EUROPEAN CENTRAL BANKS AS AN IMPORTANT INSTITUTION DURING RECESSION**

The European Central Bank (ECB) wields monetary authority throughout Europe and much of the power derives from its ability to print money. The ECB is truly unique since its purview spans seventeen sovereign countries and its policies therefore take on a transnational effect. The Bank's policies are of interest in that they are a manifestation of the greater European past—and, in particular, salient ways the German past. Of course, at the forefront is the central challenge of managing the weaker countries' debt, but the overall management of common currency members also brings about complex issues. For instance, if the fledgling nations request a bailout, a portion of their particular sovereignty can be, in essence, transferred to the ECB.<sup>35</sup>

How the theorized, or realized, transfer of sovereignty is recognized is debatable, but the ECB's hold on Eurozone members is a reality. In relation to Germany, the ECB's methods could be interpreted as a reflection of the German economic past dating to the Weimar Republic. From the German Bundesbank's perspective, it is public debt that has

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<sup>34</sup> Ibid., 365.

<sup>35</sup> Zoe Chace, "The European Central Bank's Guide to Influence," National Public Radio, July 13, 2012, <http://www.npr.org/blogs/money/2012/07/13/156705409/the-european-central-banks-guide-to-influence>.

the potential to spark inflation, and keeping austere measures stringently in place is what curbs the inflation scare.<sup>36</sup> The ECB's mission, similarly, is as the maintenance of price stability. Therefore, "The Governing Council has also clarified that, in the pursuit of price stability, it aims to maintain inflation rates below, but close to, 2% over the medium term."<sup>37</sup> The congruence in policy between the ECB and Germany is evident, but must be drawn out through comparison and through history. Simply, with Germany's growing share of influence within the ECB, and the commonalities witnessed through the evolution of ECB policy, one could point to the two bouts of inflation within Germany during the Weimar Republic as the impetus of the ECB's willingness to learn from the German lessons and from it form future policy.

#### **D. THE EUROPEAN UNION AND FINANCIAL CRISIS**

Jay C. Shambaugh et al. explained three central and inter-related causes of the Euro area's financial crisis. First, in a comparison to American firms, Shambaugh clarified that European firms "rely more on the banking system for financing," which in turn places heavy emphasis upon the banks and develops a potential single point of failure.<sup>38</sup> Within this structure, problems of solvency and liquidity arise.<sup>39</sup> Second, due to the heavy emphasis placed on individual country's sovereign debt markets, investors were forced to understand, under one currency, the varying degrees of the debt-to-gross domestic product that each country was willing to accrue.<sup>40</sup> Lastly, a growth crisis is developing into two distinct forms. Due to slow growth across the Euro area, unemployment and debt are inhibiting expeditious growth, and the Euro area's growth is uneven.<sup>41</sup>

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36 "High Government Debt Harbours Inflationary Risks, Deutsche Bundesbank Eurosystem, [http://www.bundesbank.de/Redaktion/EN/Standardartikel/Bundesbank/Views\\_Insights/background\\_government\\_debt\\_harbours\\_inflation\\_risks.html](http://www.bundesbank.de/Redaktion/EN/Standardartikel/Bundesbank/Views_Insights/background_government_debt_harbours_inflation_risks.html).

37 "Monetary Policy," European Central Bank: Eurosystem, Accessed November 12, 2013, <http://www.ecb.europa.eu/mopo/strategy/pricestab/html/index.en.html>.

38 Shambaugh, Reis, and Rey, "The Euro's Three Crises, 162.

39 Ibid., 163.

40 Ibid., 168.

41 Ibid., 170.

In the same neo-classical vein of Horst Siebert, Martin Feldstein of the National Bureau of Economic Research published, “Germany’s Economic Ills,” in 2002. At the time of writing, Feldstein portrayed a Germany with slowing growth in comparison to its Euro area partners with only a 0.3 percent increase.<sup>42</sup> The author described the German government’s predilection for economic regulation and tax hikes among “a weakening of the educational system, and the hardening of labor market rigidities.”<sup>43</sup> Feldstein detailed a more complex problem that emphasized the complications of Germany’s tie to the Euro, which routinely placed restrictions on Germany’s economic independence with broad sweeping Euro area policies. The crux of the argument relied upon the ability, or inability, of individual countries within the Euro area to handle their debt in unique ways. Another element that compounds Germany’s economic growth problem was the rigidity of employment and the rise of technology. Simply, firms were unwilling to replace employees with the new technological advances available to them.<sup>44</sup> Another drag on the economy was the inability of the German government to afford the growing population of ageing people in need of health care and social security benefits.<sup>45</sup> Much like Siebert, Feldstein attributed these factors to the decline in Germany’s growth and entrepreneur’s decisions to take risks in search of larger gains.<sup>46</sup>

The network of relationships that perpetuate the Euro area is distinct from those underpinning other regional intergovernmental organizations (IGO) found around the world. And, although similarities exist between it and the United States, the makeup of the two is extremely different and requires different analyses. Unlike the individual states that makeup the United States, the countries of the Euro area are sovereign countries, each with their own socio-political-economic agenda. Although, the issues of the common currency union are transnational in nature, much of the economic union’s infrastructure can be attributed to Germany’s economic history and its influence upon the

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<sup>42</sup> Feldstein, “Germany’s Economic Ills.”

<sup>43</sup> Ibid.

<sup>44</sup> Ibid.

<sup>45</sup> Ibid.

<sup>46</sup> Ibid.

continent. It is from the German perspective where an understanding can be developed of how the Euro area was created as well as the evolution of the ensuing sovereign debt crisis. In respect to Germany, it is evident that how each country individually manages these issues, as well as domestic issues, remains difficult. As the market and society catches up to the quickening pace of technology, one witnesses the adverse reactions it creates—as Polanyi explained in *The Great Transformation*.

### **III. THE WEIMAR REPUBLIC AND WORLD WAR II GERMANY (1918-1945)**

After World War I the Weimar Republic represented a new dawn for Germany through democracy and new governance. Yet, the Weimar Republic's bright future was overshadowed by the Allies' demands upon a weakened German nation, economy and society. The epoch from 1918 to 1933 represented a time of German socio-economic growth and collapse, through the growth of labor and union relations, and a nation under inescapable outside pressure. From the Versailles Treaty to the rise of the Nazi party, this time in history offers a glimpse into the makings of today's German social market, and provides salient aspects of cause and effect as found in the current German economy.

Therefore, this chapter will trace the evolution of the German economy through the Weimar Republic's era in history. The natural seesawing of economic policy will be drawn out and understood as Germany managed the Allies' and its society's expectations simultaneously, balancing demands for a *laissez-faire* economic system with protections and adjustments for German labor and capital. In particular, the double encounters with hyperinflation will form the majority of the argument's premise that extreme economic conditions fostered the German national sense of the necessity of effective government intervention in economic matters. Moreover, the Weimar Republic's rationale for intervention was based upon the history of social suffering through each crisis. The analysis continues through the Nazi government's reign, but takes on a new element for this epoch. Initially, Hitler managed to reduce the German people's fear of inflation and economic stagnation through intense government restructuring oriented toward a war economy. Finally, the result of World War II and Germany's economic devastation provide the foundation for the social market to take form in the post war years.

Karl Hardach divided up the interwar years of the Weimar Republic into three parts; the years directly after World War I with the inflation, the middle stable years, and the final years of the world depression with the death of democracy and the rise of

National Socialism.<sup>47</sup> The first Republic, created in the course of late 1918 and early 1919 at Weimar was dealt a heavy blow by the Versailles Treaty to the young democracy and its economy. The Versailles Treaty resulted in “the loss of 13 percent of Germany’s prewar territory, 10 percent of the population, 15 percent of the arable land, and 75 percent of the iron ore deposits, as well as reduction of pig iron production capacity by 44 percent, of steel by 38 percent, and of coal by 26 percent.”<sup>48</sup> The victors wanted to deprive the nation of its war making potential, by reordering of Germany’s borders in a smaller space, which disrupted critical lines of communication, coupled with the enormous reparation payments incurred which stretched out without limit for decades ahead. Also, the Versailles Treaty dealt a hurtful and embarrassing blow with the “‘war guilt’ clause, which blamed Germany for starting the war.”<sup>49</sup>

As war often does, World War I repurposed much of the German economy, and created an economic system capable of aligning with the needs of the state. During the period of 1914 to 1918, Germany committed to fulfilling its wartime needs, which included, in a strictly capitalist sense, an artificial realignment of industry. Yet, as the need for production increased the industrial worker did not necessarily become a mere cog in the machine with little representation. In fact, the Auxiliary Service Law “forced employers to recognize worker representation in those factories. It introduced collective bargaining and affirmed union’s right to organize.”<sup>50</sup> Moreover, its creation minimized the amount of labor strikes.<sup>51</sup> This recognition did not come easily, and many employers pushed back against the state’s labor-worker agreements.<sup>52</sup> Later, the Ruhr Lockout in 1928, whereby employers locked workers out of industrial shops in protest to high wages, demonstrated the socio-economic ramifications of collective bargaining agreements

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47 Hardach, *The Political Economy of Germany in the Twentieth*, 16.

48 Ibid., 17–18.

49 Jeffrey Fear, “German Capitalism,” ed. Thomas K. McCraw, in *Creating Modern Capitalism: How Entrepreneurs, Companies, and Countries Triumphed in Three Industrial Revolutions* (Cambridge: Harvard University Press, 1997), 156.

53 Ibid., 153.

51 William T. Ham, “Labor Under the German Republic,” *The Quarterly Journal of Economics*, Oxford University Press, vol 48, no 2, February 1934, 216.

52 Ruth Henig, *The Weimar Republic: 1919–1933* (London: Routledge, 1998), 53.



previously made.<sup>53</sup> Despite the resistance from the employers, collective bargaining between labor and industry resulted in a greater say for the former laying the basis for one of the major contemporary features of the German economic system. The period between 1913 and 1929 included a large increase in actual agreements made, and in some areas reaching 66 times the amount concluded prior to 1913.<sup>54</sup>

Despite the leaps made by labor in the form of collective bargaining and the resuscitation of the German industrial base, the war placed a toll on the Republic. The war required the willingness of large businesses to cooperate in the effort—which, in turn, meant that small and medium sized businesses could not compete against the larger and more government-market oriented businesses. During the war, German capitalism faced pressure from large business as well as from the growing demands of labor and unions, which exacerbated the growing condition of inflation and Allied blockades against Germany.<sup>55</sup> As the war progressed it became apparent that “This was a war in which, in the end, access to raw materials and production capacity were the keys to victory.”<sup>56</sup> Therefore, it is no surprise that Germany’s war effort spending rose to half of the country’s total spending.<sup>57</sup> Allied demands in the armistice, signed on November 11, 1918, that the German army return from its furthest reaches, diminish its navy to be diminished, and forfeit scores of weapons as the blockade continued thus resulted in a severe economic contraction.<sup>58</sup>

The social situation prior to the outbreak of war is crucial to understanding the character of the war and economy and the shape of the peace. Immediately preceding World War I, elite decision makers in the Kaiser’s cabinet and middle class society had loathed the advent of a socialist state with plans of widespread nationalization of industry. As the debate of a socialist agenda versus a liberal-capitalist one ensued, those

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53 Ibid., 52.

54 Ham, “Labor Under the German Republic,” 213.

55 Fear, “German Capitalism,” 156.

56 Bernard Wasserstein, *Barbarism and Civilization*, 68.

57 Ibid., 70.

58 Ibid., 95.

calling for the nationalization of German industry “proved too timid to consolidate their gains, and the capitalists proved more resilient than they had initially appeared.”<sup>59</sup> Nonetheless, the military industrial dictatorship of wartime did much to realize a state-centric practice within the German economy, in which the army and socialists cooperated as much as they leered at each other from their ideological barricades prior to 1914.

In late 1918, early in the Weimar Republic’s existence, industry operated without fear of government takeover. William C. McNeil detailed the heavy hand that German capital shortages played in the Republic’s years in government. The period of inflation from 1923 to 1924 will highlight the importance of the Weimar Republic’s ability to operate and flesh out policies to absorb financial shock, as well as rethink the government’s role in economics. Also, McNeil’s account “explore[d] the role of the Dawes Plan in resolving the conflicts between German foreign and domestic policies.”<sup>60</sup> This chapter will outline the Weimar Republic’s economy and state through the lens of Hardach’s three periods, as well as analyze the policies put in place. This experience is essential for any sensible understanding of the political economy of Germany and the role of the past and its signal events as a guide in the present. Such knowledge hardly exists in the present among those outside of Germany who routinely fail to understand the sources of cause and effect in the past and present.

#### **A. BEGINNING OF THE WEIMAR REPUBLIC—1918 TO 1923—THE FIRST TRIMESTER**

The new republic emerged in the defeat of the fall of 1918 with a veil of shame that betrayed the existence of enduring sources of strength in the German economy amid intense political and social conflict at home and around Germany. The endurance of old elites, the first attempts by the republic to find its way, war guilt and the reparations issue framed the early years of the new republic and damaged the international political economy in which Germany existed, a fact that applied generally in central Europe, if not Europe as whole. Reparations had been central to the Franco-German enmity in the 19th

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<sup>59</sup> William C. McNeil, *American Money and the Weimar Republic: Economics and Politics on the Eve of the Great Depression* (New York: Columbia University Press, 1986), 5.

<sup>60</sup> Ibid., 6.

century, with the Reich placing a huge burden on a defeated France, which nonetheless paid off its debt. This memory operated at Versailles, where victors did all they could to break German power.

The reparations burden placed on Germany is usually cited as 132 billion gold marks but Sally Marks believes it was only 50 billion gold marks.<sup>61</sup> She attributes her findings to the fact that Germany “had an excellent propaganda position and made the most of it, leading the English-speaking world to believe that the reparations burden was both outrageous and unpayable.”<sup>62</sup> Reparations took many forms, and Germany found itself in a position paying a war debt and benefits to veterans as well.<sup>63</sup> The reparations demanded of Germany after World War I had a compounding effect upon its economy. Germany’s balance of payments deficit exaggerated inflation, and “rais[ed] the cost of imports and consequently the cost of production.”<sup>64</sup> As the reparations remained unpaid, the credit line of the German government diminished, and inflation devalued German money so much that payments became nearly impossible. To put the inflation crisis of 1923 in perspective, it took 1,542 German Marks to buy a single United States Dollar in January of 1920.<sup>65</sup> By November 1923, one U.S. dollar could purchase 219 trillion Marks.<sup>66</sup> Perhaps more staggering, “Wholesale prices increased from 57% change in May to a 29,586% change in October of the same year, while the exchange rate increased from a 95% change in May to a 25,957% change in October.”<sup>67</sup>

The growing rate of inflation of the German Mark affected the beleaguered German people as well as outsiders. Hardach wrote, “most of the time the external value of the mark fell faster than internal prices,” which created an interesting situation for

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61 Sally Marks, “Reparations Reconsidered: A Rejoinder,” *Central European History*, vol 5, no 4, December 1972, 358.

62 Ibid.

63 Hardach, *The Political Economy of Germany in the Twentieth Century*, 18.

64 Ibid., 19.

65 Ibid., 20

66 Ibid.

67 Meaghan Rubsam, “Disorder and Early Sorrow,” The Modernism Lab, Yale University, [http://modernism.research.yale.edu/wiki/index.php/Disorder\\_and\\_Early\\_Sorrow](http://modernism.research.yale.edu/wiki/index.php/Disorder_and_Early_Sorrow).

foreigners purchasing Marks.<sup>68</sup> For Germans inside of Germany, the rising rate of inflation made it possible for investors to profit, and enabled investors from abroad to profit greatly in various areas. A bank borrower could make a large amount of money since what was originally taken out decreased in value, making it easier to pay; indeed, “the Reich, was thus able to pay off its internal war debts with ease.”<sup>69</sup> Such was, after all, the goal of the policy of inflation to eradicate such debts. Outsiders used the same method since their ability to payoff German loans was made easier as time continued and inflation rose.

For the German citizen, especially the member of the middle class for whom thrift and other such virtues were ingrained in culture and society for centuries prior, inflation raised the prices of goods drastically. Moreover, the rate of inflation grew at such a fast pace that the actual printing of money could not keep up. This fact meant that wages, market sales, and other transactions suffered due to a lack of physical currency. Since it cost so much money to purchase an item or pay a laborer, the requisite currency had to be available for distribution. In effect, the Mark became useless, and the German citizen had to come to grips with its depleted value. With a devalued Mark and lack of physical currency, the German market came to a halt causing food shortages.<sup>70</sup>

Ultimately, Hardach attributed Germany’s period of hyperinflation in 1923 to the enormous war reparation payments demanded by the Allies as well as the inflation that had begun in wartime. The aforementioned figure of 132 billion gold marks “bore no relation to the claims originally presented by the victor states, but was simply the one the Allies could agree upon in view of inter-Allied debts.”<sup>71</sup> France was to receive the largest percentage of the reparations payments, but by 1922 it became a reality that Germany was incapable of paying the Allies agreed upon payment scheme.<sup>72</sup> Also, the large sum of payments required Germany to seek creative solutions, which resulted in the

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68 Hardach, *The Political Economy of Germany in the Twentieth Century*, 21.

69 Ibid.

70 Ibid., 21–22.

71 Ibid., 24.

72 Ibid., 25.

borrowing of money from the Reichsbank instead of levying taxes from its citizenry. Paradoxically, issues arose when Germany made good on its war debt through the transfer of duty free exports. Since countries such as France and Great Britain were industrial equals to Germany, as Germans introduced their products into the Allies' market unwanted competition ensued.<sup>73</sup> This problem opened a greater role for the United States and ushered in, despite crisis, a period of stabilization that itself was at risk in the further evolution of the German republic.

**B. THE MIDDLE YEARS OF THE WEIMAR REPUBLIC—THE SECOND TRIMESTER: 1924–1928/9.**

The unsolved issues of inflation and the failure to resolve the outstanding war reparations inhibited Germany from paying France what it was due under the Treaty of Versailles. In response to Germany's inability, or lack of interest, to pay France, "French Premier Raymond Poincare decided on another method of solving the issue and sent French troops into Germany's industrial Ruhr River Basin in January 1923 to force Germany to meet its obligations under the treaty of Versailles."<sup>74</sup> After continued stalemate between France and Germany, the United States sent an unofficial committee to investigate what was necessary to enhance Germany's economic stability.<sup>75</sup> While the Americans had grown increasingly wary of French policy in Germany, they had withdrawn their troops in 1922, but believed, wrongly as it turned out, that American financial power was sufficient to manage central Europe without security guarantees in the League or in a real role for the U.S. on the continent.

Named after Charles G. Dawes, the committee consisted of American businessmen, and its creation sparked separate discussions of its intent inside and outside of Germany. American examples of economy and society had become models for many in Germany in the 1920s, when U.S. commercial activities in Europe took off in the wake of the war. Skeptics worried that the Americans wanted to secure a political victory

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<sup>73</sup> Ibid.

<sup>74</sup> McNeil, *American Money and the Weimar Republic*, 25.

<sup>75</sup> Ibid., 25–26.

before the elections of 1924 kicked off, and worried little about what truly became Germany's economic future. The plan created, after the committee's deliberations from January to April of 1924, appeared to be unfeasible in practice, and it attempted to distribute to the Allies every Mark available without harming Germany's economic security. By creation, the plan called for Germany to pay 2.5 billion RM per year if it were economically feasible. If these conditions could not be met, Germany would pay what it could so that its financial integrity remained intact.<sup>76</sup> In practice, taxes to fund reparations payments came from "a transportation tax on the Reichsbahn (the national railroad), and the interest payments on newly created mortgages of the Reichsbahn and of all large industrial enterprises."<sup>77</sup> Additionally, the Reichsbank removed itself from government control, and Germany raised taxes that would fund a budget surplus. Without the Reichsbank as sole creditor to the German financial institution, and a newly established tax income, Germany could make financial strides toward paying its war reparations debt.

Among German financiers, the Dawes Plan suggested an un-payable war debt, and was a plan that would never be fulfilled. Despite a generally unwilling German population, Karl Ritter of the Foreign Ministry "argued that in the short run, the plan offered the best chance for German economic recovery...But he believed that this growth would probably not be sufficient to permit transfer of the full 2.5 billion marks."<sup>78</sup> The Plan called for a loan to propel the German economy into economic prosperity, and the United States provided the bulk of a German stimulation loan with 400 million RM.<sup>79</sup> The Dawes Plan consisted of two important aspects, both of which are particularly salient in respect to today's European economy. Tangibly, Germany issued bonds at 1,027 billion RM and at such a high rate that they became oversubscribed.<sup>80</sup> The large sale of German bonds drove the market price higher, which enabled investors to sell them at

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<sup>76</sup> Ibid., 24–28.

<sup>77</sup> Hardach, *The Political Economy of Germany in the Twentieth Century*, 30.

<sup>78</sup> McNeil, *American Money and the Weimar Republic*, 31.

<sup>79</sup> Ibid., 32.

<sup>80</sup> Ibid.

profitable prices.<sup>81</sup> In addition, the United States' monetary backing of the Dawes Plan represented solidarity between the Americans and Germans, which helped foster a strong German market.<sup>82</sup>

Ultimately, from the creation of the Dawes Plan to the issuance of the Dawes loan on October 10, 1924,<sup>83</sup> the Plan spanned across the first and second trimesters of the Weimar Republic's existence. Hardach titled the first period of the Weimar Republic as "the chaotic times of inflation and Excessive Reparation Demands,"<sup>84</sup> and the second trimester as "The Stabilization and Prosperity Period."<sup>85</sup> Certainly, the Dawes Plan addressed the overwhelming issue of German market insecurity fueled by inflation and reparations. The years of prosperity to follow, from 1923 to 1929, validated much of the Dawes Plan, "so well, in fact, that the statesmen of the creditor nations advocated a permanent and final settlement in place of [the] transitional arrangement."<sup>86</sup> In the eyes of German nationalists and enemies of the Versailles and Weimar system, this U.S. intrusion into the life and economy of the nation represented an outrage and a trespass on sovereignty the echoes of which contrast with the international political economy of the post 1945 regime and also casts a light on the most recent phase in the evolution of the German economy and its place in Europe and the wider world.

The Dawes Plan minimized the negative effects of inflation in the German economy, and spurred important reforms of state and economy within the German government that took hold in the middle of the 1920s and followed with a period of calm and relative prosperity. As a requisite, government spending had to be curbed since its "budgetary deficits had been the immediate cause of inflation."<sup>87</sup> In addition to stabilizing the economy by eliminating inflation, stabilization came in the form of

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81 Ibid., 33.

82 Ibid.

83 Ibid., 32.

84 Hardach, *The Political Economy of Germany in the Twentieth Century*, 16.

85 Ibid., 28.

86 Ibid., 38.

87 Ibid., 29.

currency reform---a significant feature of how the German economy has worked in the 20th century with some relevance for the contemporary issue as well. The creation of the Rentenmark in October 15, 1923 attempted to serve that purpose in order to establish confidence in German currency. Indeed, the Rentenmark reintroduced German confidence by diminishing inflation, but its purpose was a part of a long-term plan to establish the Reichsmark. Where the Rentenmark's "value was set at one gold or prewar mark, and at 4.20 to the dollar or at one trillion paper marks on 15 November,"<sup>88</sup> the new Reichsmark was "Equal in value to the Retenmark...had to be 40 percent backed by gold or foreign exchange, and the rest covered by commercial bills of exchange."<sup>89</sup>

The middle years of the Weimar Republic encountered success from the advancements made by the Dawes Plan as well as the boom in the Atlantic economy. Additional reforms, aside from those in government expenditure, developed from the restructuring of the marketplace and also contributed to Germany's recovery. The standard of living in the Republic rose, and "National income rose throughout the second half of the 1920s, and by 1928/29 the country was at or above 1913 levels of production and general welfare."<sup>90</sup> This German success can be attributed to the difficult, but necessary, shift in market economic policy and structure via modernization, efficiency and consumer goods as well as restructuring among the producing industry, i.e., steel. With the creation of a German wartime economy driven by the Great War, an artificial market determined the means of production and what products were deemed necessary by the government. To continue a war driven economy was not acceptable nor a viable solution since it required a government willing to invest in artificial market spaces attached to unreasonable prices.

So that the German market could be reoriented to meet the demands of a non-wartime Germany, the market economy reconfigured its structure and mindset from one of "technical rationalization" to "economic rationalization," with a strong American

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<sup>88</sup> Ibid., 28–29.

<sup>89</sup> Ibid.

<sup>90</sup> Ibid., 31.



accent.<sup>91</sup> Instead of attempting to fuel a bustling war economy, Germany had to pursue what made economic sense in a peacetime world. Large factories structured to produce fighting-goods no longer served the purpose of consumer goods in a civilian marketplace. Inherent problems resided in Germany's pursuit of economic rationalization, but were deemed as acceptable risks. Mainly, German economists viewed a shift in attention would bring about over modernization.<sup>92</sup> From 1924 to 1929, the American accent in German economic rationalization took on a liberalized form, but did not divorce itself from the unique worker-employer relationship. However, the way in which industry employed their workers took a more neoclassical turn. For example, Smith attributed three critical elements to the effectiveness of his division of labor theory; dexterity, time, and the machinery that allows it to occur.<sup>93</sup> Resembling Smith, Ruth Henig explained, "Industrial managers reorganised and modernised the means of production in their factories in a bid to increase the productivity of workers. Mass production was facilitated by a more organised division of labour. The result was a great expansion of output per worker."<sup>94</sup>

The theory of German overmodernization conjures up two distinct and separate views, or aspects, explained by Karl Polanyi and by Alexander Gershenkron. If Germany became overmodernized, its experience in doing so, as described in Polanyi's *The Great Transformation*, would be one instance of a double movement. In order to meet the needs of the economy central government control must be relaxed, but because measures of protection would decline and technology would advance quicker than the worker's ability to master it in a timely fashion a natural opposition force would ensue in what was and still is a somewhat conservative society and economy. Gershenkron's theory of leapfrogging could be applied to this era in that during the period of World War I Germany focused on war infrastructure instead of societal-economic maintenance.

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91 Ibid., 32.

92 Ibid.

93 Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (London: The Electronic Book Company, 2001), 21–22.

94 Henig, *The Weimar Republic: 1919–1933*, 47.

Therefore, following the war, the Weimar Republic's market reorientation allowed for this leapfrogging to occur. Since the war machine of Germany dismissed much of the market's needs as its primary focus rested on supplying the war effort, the Weimar Republic became technologically backwards. But, Gerschenkron would argue this could be considered a possible advantage, and that Germany could capture the innovative talent flooding across its borders from the United States in the form of scientific and technological expertise.<sup>95</sup> This process of rationalization with U.S. origins became known as Americanization, or Taylorism (F.W. Taylor, inventor of scientific management), of the production line and rigorous management by efficiency could be seen. Once captured, Germany could reverse-engineer products or, better yet, makes advancements upon established productions. Moreover, actors in the international market, such the United States, had a motivation in the advancement of the German market and "The paramount lesson of the twentieth century is that the problems of backward nations are not exclusively their own. They are just as much problems of the advanced countries."<sup>96</sup> The Dawes Plan fostered this tendency with a closer bond between the two countries for better or worse. Improvements in the 1920s certainly seemed at the time to be a fine alternative to the over-arching dislocation of the immediate postwar years.

As rationalization set in as an economic reality, it became twinned with an emphasis on cost effectiveness toward the goals of scientific management and getting more value out of labor. Cost effective solutions did not always emanate from government, and, in fact, the phenomenon of cartelization proliferated—that is, the division of the market between leading industries, the most famous of which was the I.G. Farben, and another was the Auto Union. Americanization coupled with cartelization created a unique set of dimensions in the German economy and emphasized the growing tensions between society and the market. Cartelization formed in the face of the attempts made toward increased market competitiveness, but served the purpose of keeping prices

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<sup>95</sup> Hardach, *The Political Economy of Germany in the Twentieth Century*, 32.

<sup>96</sup> Alexander Gerschenkron, *Economic Backwardness in Historical Perspective* in *The Political Economy Reader: Markets as Institutions*, eds Naazneen Barma and Steven K. Vogel (New York: Routledge, 2008), 227.

low.<sup>97</sup> Along with growth in cartelization, the German government leveraged more power in German banking and market reforms, which provided it a vetoing seat at the decision table with “producers, traders, union representatives and independent experts.”<sup>98</sup> The steel and chemical industries experienced a particular proliferation in small and medium sized cartels, which laid the foundation for national and international agreements.<sup>99</sup>

In the Weimar Republic, labor interacted with its management counterparts in far different ways than in previous years in Germany. Ham quipped, “[the laborer] became, indeed, one of the chief pillars of the democratic state.”<sup>100</sup> Writing directly after Nazi takeover, Ham despaired as he witnessed what he viewed as the most revolutionary labor movement being abolished under totalitarian rule. Moving from solely backing the employer to backing both employer and worker, the Weimar Republic came to a more robust and fuller understanding of labor-management dynamics.<sup>101</sup> The growth of unions increased and workers found themselves beneficiaries of “the recognition of the unions and of collective bargaining, the acceptance of joint arbitration boards and employment exchanges, and the granting of the eight-hour day and of the right of workers to be consulted in all matters affecting their interests.”<sup>102</sup> Of course, these newly acquired advantages were borne from the government’s appeasement and fear of a Soviet-styled revolution, but ought not to be forgotten. The Weimar Republic’s Constitution’s Article 165 put laborers as equals to their management counterparts in the negotiation of “wage and working conditions, and in the direction of industry.”<sup>103</sup> The personal and organizational relationships during the Weimar Republic’s years in control were unparalleled in the past and advanced the laborer’s position for the future.

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97 Hardach, *The Political Economy of Germany in the Twentieth Century*, 33.

98 Ibid., 35.

99 Fear, “German Capitalism,” 159.

100 Ham, “Labor Under the German Republic,” 203.

101 Ibid., 204.

102 Ibid., 206.

103 Ibid., 207.

Despite the advances made in cooperation between government, industry, and labor, the issues of reparations and methods of payments endured. The fact remained that “Germany was not really earning her reparation payments, which was contrary to the spirit, though not the letter, of the Dawes Plan.”<sup>104</sup> Germany faced a conundrum in attempting to modernize through plans of rationalization while paying its reparation payments as set out in the Dawes Plan.<sup>105</sup> Modernization was expensive, but necessary to remain globally competitive.

To outsiders, such as those profiting, the successes of the Dawes Plan called for an upping of the potential returns. Although with little regard for the current German economic woes, the Young Plan of 1930 placed a definitive end date to reparation payments, in 1988, and a solid German debt of RM 37 billion.<sup>106</sup> The Young Plan set a concrete timetable and a payment cap, but the “[payments] were well above what Germans thought they could afford and had hoped to pay.”<sup>107</sup> Between the Dawes and Young Plans, the achievements each plan attempted to gain symbolized differences in American and German opinion in the paying of reparations. The Young Plan was abandoned and the Great Depression was the new international reality. At a time of typical bust following a period of boom, “government policy and Germany’s monetary weakness combined to deliver the fatal hammer blows that made this depression worse than any previous capitalist experience.”<sup>108</sup>

### **C. THE GREAT DEPRESSION—THE THIRD TRIMESTER 1929–1933.**

Coupled with the natural ebbing of a relative period of boom in Germany that began in 1928 and stumbled into disaster after October 1929, “The breakdown of the international financial system in the 1930s made a major contribution in turning local

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<sup>104</sup> Hardach, *The Political Economy of Germany in the Twentieth Century*, 37.

<sup>105</sup> Ibid., 36–37.

<sup>106</sup> Ibid., 38.

<sup>107</sup> McNeil, , *American Money and the Weimar Republic*, 234.

<sup>108</sup> Ibid., 237.

depressions into a prolonged world-wide depression.”<sup>109</sup> With its massive worldwide exporting power as well as its role as international creditor and especially sponsor of the German economy with the Dawes Plan, the United States bore most of the blame as well as the catalyst to other nation’s periods of depression. In Germany, the depression generated fateful and finally fatal effects on the government and the German market. Also, the borrowing that occurred only a few years prior to the onset of depression exacerbated the problem even further. In 1930, it was not just war reparations that Germany found troubling, but now loans in the form of stimulus were difficult to pay back. The boom in the United States prior to the period of bust included enormous amounts of investment in American funds versus in German investments.<sup>110</sup> The Weimar Republic’s political and economic infrastructure could not accommodate the exogenous shocks generated by the failing market on Wall Street.

Hardach correctly believes that the United States and thus Germany received the heaviest blows from the Great Depression. With the Weimar Republic’s dependence on American investment, the two markets interlinked themselves to such an extent that untangling the two became impossible without catastrophe. To ease the pain in Europe, President Edgar Hoover issued a moratorium for German war reparations, a move that was sure to irritate others. The Hoover Moratorium received ample criticism, especially from France, but it “became too late to stem the tide, and on 13 July [1931] the Danat Bank, one of the biggest German banks, declared its insolvency.”<sup>111</sup> It became essential for government bailouts, followed by government majority shareholding, to take place so that the German economy could continue to function. With little capital and credit, German banks decreased their lending frequency to industry by half.<sup>112</sup>

The suffering experienced by all in the decade previously formed much of popular and government opinion on how the depression should be handled. The fear of inflation was real and still in recent German memory, and the printing of money to handle a lack

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<sup>109</sup> Ibid., 238.

<sup>110</sup> Hardach, *The Political Economy of Germany in the Twentieth Century*, 40.

<sup>111</sup> Ibid., 42.

<sup>112</sup> Ibid.

of capital no longer met the expectations of the general population. In sum, Germans feared a markup of prices and could not endure another marketplace that required wheelbarrows full of currency to buy household goods. Therefore, in order to curb fears of inflation, the Brüning government pursued a deflationary policy. Yet, in combination with the Great Depression, the market's downward spiral was too heavy for the government to correct. Again, reparations hastened the problem and resulted in increased taxes throughout the German population.<sup>113</sup>

In what could be considered an endogenous shock, the Brüning government resorted to what many economists recommended a liberalization of the market.<sup>114</sup> Brüning's methods dealt a blow to labor, and represented an undoing of the labor-friendly social market principles that had been emerging in the Weimar era. In a time of unease, Brüning contradicted the ideals that Keynes fostered and disintegrated elements of confidence within the German market. Acting on the belief, "that in advocating inflationary techniques he was undermining any kind of reasonable financial policy for Germany,"<sup>115</sup> Brüning pursued a deflationary policy that "cut unemployment benefits, government salaries and veterans' benefits. In so doing, he weakened the popularity of the Weimar Republic and paved the way for Hitler's rise to power."<sup>116</sup> The results came as massive blows to wages and rents, which resulted "in a corresponding reduction of consumer demand."<sup>117</sup> Abroad, demand for German goods dissipated while the depression continued to affect foreign countries.<sup>118</sup> With few German goods purchased domestically and abroad, unemployment increased and Chancellor Brüning found himself out of office.

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<sup>113</sup> Ibid., 46.

<sup>114</sup> Ibid., 45–46.

<sup>115</sup> George Garvy, "Keynes and the Economic Activists of Pre-Hitler Germany," *Journal of Political Economy*, vol 83, no 2, April 1975, 402.

<sup>116</sup> Philip Coggan, *Paper Promises : Debt, Money, and the New World Order* (New York: Public Affairs, 2012), 88.

<sup>117</sup> Hardach, *The Political Economy of Germany in the Twentieth Century*, 46.

<sup>118</sup> Ibid., 47.

#### **D. CONFIDENCE RESTORED BY THE NAZIS AND THE COST OF WAR**

The Weimar Republic represented a little over a decade of economic progress in the form of labor and industry relations, as well as the progression of social market policies. After the fall of the Weimar Republic in 1933, the Nazi government reoriented the role of capitalism in different terms from its predecessors. The Nazi form of capitalism involved the eradication of labor unions and the subjugation of industry to the needs of the total Nazi state, which embarked, at first on a series of work creation projects, such as motorways, followed, in turn, by a break neck program of rearmament. Thus, the way in which the Nazis used the market benefitted the state's successful trajectory toward war, and certainly not the growth of small and medium sized businesses coupled with the protection of labor rights. The Nazi program was directed against the world economy, especially against the English speaking world, whose domination of the economy in their anti-Liberal and anti-Western minds was also a work of a conspiracy of enemies of the regime, especially Jewish bankers and those who the Nazis perceived as the real authors of misery in the world. These racist ideas formed the basis for a reordering of state and economy, in which the victimization and plunder of Jewish businesses was a notable feature of Nazi economics. This mindset continued with the epoch of conquest and war so that it expanded on a continental scale. This system of state capitalism and the rise of the *Schutzstaffel* (SS), becoming itself a criminal industrial empire on its own in league with private industry, signifies an important feature of the Nazi economy.

The motor industry, with its American prototype, especially profited from Nazi policy, where auto ownership and road building were features of prosperity as well as reorganization of the motor industry on more or less the pattern of rationalization and modernization, but with Nazi military and social goals in mind. Consumer goods were downplayed on the U.S. pattern, as wages and prices were controlled. The hard currency problem connected with Nazi economy policy led to the Four Year Plan in 1936, and a series of bilateral agreements whereby the Germans extracted themselves from the structure of world trade, and began barter with south eastern and eastern European

nations, i.e., Romania and Hungary, a series of measures that were the prelude to conquest.

In 1948, Newman explained, “Under the Nazi economy all industry was divided into either Fachgruppen (functional trade groups) or Wirtschaftsgruppen (economic groups) under the minister of Economics.”<sup>119</sup> Where once cartels had strong leverage in the negotiating power of price and wage, the Nazi government slowly did away with their influence in such matters via the reordering sketched out above. Instead of functioning as a separate entity from government, the reality was that “So long as the Nazi government could make use of the traditional cartel structure, it was permitted to exist.”<sup>120</sup> In essence, with the dissolving in 90 percent of pre-Nazi cartels, the true motivation of the Hitler government revealed itself—the Nazi total government would decide what is beneficial to the state and society by its lights, rather than leaving these outcomes to a liberalized market.<sup>121</sup>

Under the Nazi government at the center of attention was the people’s community, and certainly not individual interests or the market as an end in itself as part of a reviled world economy.<sup>122</sup> The requirement to feed the population under the new government was possible through the exploitation of small businesses and the expansion of German-governed land. Of great economic importance was the Nazi shift in focus from exports to self-sufficiency.<sup>123</sup> As the government looked inward, Hitler ensured that German wages and employment increased. Whether created from past chancellor’s policies or not, the German population’s confidence in government took an upswing as well.<sup>124</sup>

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119 Philip C. Newman, “Key German Cartels under the Nazi Regime,” *The Quarterly Journal of Economics*, vol 62, no 4, Aug 1948, 576.

120 Ibid., 577.

121 Ibid.

122 Hardach, *The Political Economy of Germany in the Twentieth Century*, 53.

123 Ibid., 57.

124 Ibid., 59–60.



The Nazi regime placed a premium on secrecy “since some of the countercyclical measures also benefited the country’s military potential, thus killing two birds with one stone.”<sup>125</sup> Of greatest secrecy prior to 1935 was the rearmament of the German military. Hitler reversed Germany’s adherence to the Versailles Treaty, and beginning in 1935 military expenditure increased with a sum of 60 billion RM by the start of World War II.<sup>126</sup> If confidence allowed for the success of Nazi inflation policy, then military rearmament was made possible through gradual shift from a social market economy to one under government central control.<sup>127</sup> Yet the Nazi’s altered the German economic system toward something new that resembled neither a liberalized market nor a communist system, and did so by keeping businessmen in positions of authority, with sharp restrictions, to keep competition alive.<sup>128</sup>

The war effort required minor and major changes in policy by the German government. As the need for men on the frontlines rose, their presence in the factory or field at home disappeared. Therefore, the elderly population and women, given waivers in the past, found themselves at work, and working hours increased as well. The country’s industrial profile also changed—led by the armaments industry’s rise in labor “by 28 percent between December 1941 and June 1944.”<sup>129</sup>

Nevertheless, the Allies’ air offensive against the Reich took a toll on the capacity of German economic output. Transportation, such as railways, and factories endured heavy damages, and “about one-seventh of German industrial capacity had already been occupied by the advancing Russian army.”<sup>130</sup> German economic infrastructure was beyond Nazi repair, but more importantly the German worker was left without work and little more at home. After six years of total war, the Nazis proved that Joseph Goebbels was correct that “if the Nazis left the stage in defeat, they would know how to slam the

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125 Ibid., 62.

126 Ibid.

127 Ibid., 64.

128 Ibid., 66.

129 Ibid., 81.

130 Ibid., 83.

door behind them.”<sup>131</sup> Among those economic resources destroyed from the war were housing structures, factories, lines of transportation, and a foundation for a functioning and successful German social market. Reform would be necessary, but would not come immediately and the Marshall Plan would be the first band-aid on Germany’s wounds. In addition, the victors of World War II would find it easier to implant their methods and ideals in the German marketplace.

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<sup>131</sup> Ibid., 86.

#### **IV. POST WORLD WAR II: FEDERAL REPUBLIC OF GERMANY**

The years directly after the Second World War proved to be a critical time in Germany's socio-political and economic history. Unlike the end of World War I, the Allies eventually abandoned a punitive economic peace in favor of common sense, and after a period of inaction West Germany received the infrastructural aid it needed and ought to have received the first time. This era as a whole witnessed Germany moving through several dramatic stages—first, a country in dire need and underdoing reconstruction, then a global economic power enjoying prosperity and struggling with stagnation, and ultimately reunification. This complex trajectory was embedded with events that represented the natural push and pull between the government, industry, and laborers with the German economic social market. This period was influenced by the two bouts with hyperinflation in the Weimar Republic and the proceeding Nazi regime's method of governance, which understandably shaped the layers of protection afforded to the German worker. Furthermore, the post war period up to the reunification of East and West Germany is the proper foundation through which to understand the German position in the Euro area's economic crisis of 2007. Also,

The years following the Second World War gave birth to West Germany's social market economy as well as the 'German miracle.' The social market set the standard for how the German economy would operate, and the German miracle described the relatively quick success Germany enjoyed. Unfortunately, despite a strong industrial base, West German growth was delivered a blow with the old Nazi system set in place. Kerber and Hartig explained the problem was "the restrictive institutional framework for economic transactions which was the heritage of the centrally administered Nazi economy."<sup>132</sup> Simply, the artificial restrictions—wages, rationing of goods, set prices—

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<sup>132</sup> Wolfgang Kerber and Sandra Hartig, "The Rise and Fall of the German Miracle," *Critical Review*, Summer 1999, 13, 3/4, 338.

put in place by the Nazis continued to affect the German market and its ability to grow.<sup>133</sup>

The Americans controlled much of West German economic thought directly preceding the war, and this influence—combined with the United States’ growing distrust of communist Soviet Union to the east—emboldened a strong push toward a neo-liberal market system in the immediate postwar period. The West German political canvas was divided between the Social Democrats (SDP), who wanted nationalization, and “represent[ed] mostly workers and about one third of the total electorate;”<sup>134</sup> and the Christian Democrats (CDU), who sought a liberalized agenda.<sup>135</sup> Although a liberalized market appealed to many German policy makers, the complete ridding of government control was not the aim. Despite the economic mayhem produced by the Nazi government, complete adherence to a self-regulated market did not appear sufficient to propel the German market in a desirable direction. War torn Germany sought an effective and successful market, but in 1947 the Christian Democratic Party (CDU) “members were convinced that private capitalism had failed and that the nationalization of key economic sectors would be more conducive to general welfare.”<sup>136</sup> Specifically, the CDU, “in their Ahlen Program of February 1947...advocate[d] public ownership of ‘enterprises of monopoly character,’ particularly in the coal and iron industries.”<sup>137</sup> This particular point of view was born from experiences of economic depression and previous failures in economics driven by price mechanisms with little to no government intervention. The debate of whether a strict liberal economic interpretation or one based on the social agenda ensued, but first Germany and Europe-wide reconstruction had to be addressed.

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133 Ibid.

134 Hardach, *The Political Economy of Germany in the Twentieth Century*, 141.

135 Ibid.

136 H. J. Braun, *German Economy in the Twentieth Century* (London: Routledge, 1990), 176.

137 Hardach, *The Political Economy of Germany in the Twentieth Century*, 142.

## A. THE MORGENTHAU PLAN AND THE MARSHALL PLAN

The Allies divided up post World War II Germany between the four victors—the United States, Great Britain, France, and the Soviet Union—with the goal of keeping Germany “decapitated and quartered for the time being.”<sup>138</sup> Yet, the regressions made after the Great War could not occur again, although attempts to do just that occurred through plans such as the Morgenthau Plan. The plan set the standard of living in Germany back to the levels of 1932, and then set the industrial agenda to match those needs.<sup>139</sup> The Morgenthau Plan called for mass de-industrialization of Germany, and if pursued to its fullest extent could have devastated Germany’s industrial base. Morgenthau-ism halted, and when “the capacity of the steel industry in the Western zones had been reduced by 6.7 million tons, the three Western Allies, in order to enhance the prestige of the government of newly established Federal Republic, exempted 17 more plants from further dismantling.”<sup>140</sup> After four years of overlap with the Marshall Plan, de-industrialization ceased.<sup>141</sup>

The creation of the Marshall Plan in 1947, by United States Secretary of State George Marshall, “was an attempt to link aid to the reform of European institutions and practices.”<sup>142</sup> The plan achieved this aim by, first, asking the European countries how they would benefit from aid best and, second, by ensuring sustained growth through economic and political stabilization.<sup>143</sup> In many ways the Marshall Plan laid the foundation for many of the core tenets found in the European Monetary Union. Specifically, the Marshall Plan “sought to organize European institutions with the power to transcend sovereignties and coordinate policies so that normal market forces could

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<sup>138</sup> Ibid., 90.

<sup>139</sup> Ibid., 92.

<sup>140</sup> Ibid., 95.

<sup>141</sup> Ibid., 95.

<sup>142</sup> Michael Cox and Caroline Kennedy-Pipe, “The Tragedy of American Diplomacy? Rethinking the Marshall Plan,” *Journal of Cold War Studies*, vol 7, no 1, Winter 2005, 109.

<sup>143</sup> Ibid.

operate.”<sup>144</sup> Marshall’s plan intended to create an environment whereby Europeans appeared in control of their future with aid from the United States. Skeptics posited that the United States created a system that encouraged only one path to success that was heavy with American influence. The United States focused on “rebuild[ing] West Germany in a way that would not pose a threat to France and other neighbors.”<sup>145</sup> Whether the motive of the Marshall Plan was to prop up European economics versus hinder the growth of Communism in Europe, or both, is debatable, but the plan was a success with a caveat. Simply, Europe’s economic history placed emphasis on the market and entrepreneurship, which created an apt environment for the Marshall Plan to deliver large sums of money and find success.<sup>146</sup>

## **B. WEST GERMAN ECONOMIC AND POLITICAL REFORM OF THE 1950S**

The continued presence of past Nazi economic policies was not only harmful but also necessitated effective reform so that Germany could restore its market economy. Unlike the policies of Nazi Germany, Western German reforms pulled away from central planning and focused on the re-liberalization of its market, which required price controls to be lifted.<sup>147</sup> Currency reform created the Deutschmark and the market economy could pursue a system of price rather than barter.<sup>148</sup> To follow, tax reform and a ban on cartelization “enunciated a clear commitment to a market economy and the beginning of a broad program of liberalization.”<sup>149</sup>

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144 Michael J. Hogan, *The Marshall Plan: America, Britain and the Reconstruction of Western Europe, 1947–1952* (Cambridge: Cambridge University Press, 1987), 428.

145 Derek Chollet and James M. Goldeier, “The Faulty Premises of the Next Marshall Plan,” *The Washington Quarterly*, vol 29, no 1, Winter 2005–06, 10.

146 Ibid., 14.

147 Kerber and Hartig, “The Rise and Fall of the German Miracle,” 339.

148 Ibid.

149 Ibid.

## 1. Decartelization Policies

The American ideal for the liberalization of the market economy met ample criticism, and did not necessarily represent the West German method to reconstruction within its economic borders. Specifically, the issue of cartelization received divided attention. Internally, Germans “wanted to refurbish the national economy in accordance with the ‘German tradition,’ which in no way saw cartels and other forms of market agreements as inimical to the national economy.”<sup>150</sup> The United States envisioned a method in different terms based upon liberal economic policies that based market relationships upon the price mechanism and liberalized interactions. Cartels fueled artificial relationships that introduced market distortions, and presented a clear barrier to true economic prosperity as viewed by the Americans. In terms of decartelization as mandated by the Allies, specifically the United States and the United Kingdom, laws brought forth in 1947 “aimed at preventing the misuse of economic power and the collusion of a few enterprises which were detrimental to the consumer.”<sup>151</sup>

In true Polanyi-form, the decartelization of Germany garnered strong positive and negative reactions. On the one hand, Germans viewed decartelization as un-German and destructive to their form of capitalization, and on the other hand the United States and supporters determined German policy maker’s lack of expediency to legislate comprehensive cartel laws as unproductive. Typical of the push and pull found in government, citizens, international pressures, and “Domestic constraints induced the Americans and the West German pro-cartel industrialists to make a compromise with each other.”<sup>152</sup> After nearly a decade of continued Allied rule on decartelization and many attempts to pass such laws in West German Parliament, the Federal Cartel Authority was established in 1957.<sup>153</sup> Ultimately, the Economics Minister maintained the

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150 Chansoo Cho, “Manufacturing a German Model of Liberal Capitalism: The Political Economy of the German Cartel Law in the Early Postwar Period,” *Journal of International and Area Studies*, vol 10, no 1, 2003, 41.

151 Ibid., 46.

152 Ibid., 48.

153 Ibid.

ability to deem the need for specific cartels for in certain instances as necessary to economic success.<sup>154</sup>

## **2. Laying the Foundation for Economic Success**

German economic success ensued, but the price of converting to the Deutschmark was its incompatibility in the international market. The creation of the European Payments Union (EPU) helped ease the pain of incompatibility. “Overshadowed by the events in Korea,” Henry H. Schloss wrote, the agreement “made further progress in the elimination of trade barriers between the member countries of the Organization for European Economic Cooperation (O.E.E.C.), which include[d] practically all of western Europe.”<sup>155</sup> Moreover, the Korean War provided an increased demand for German exported goods to aid the American war effort. <sup>156</sup> The elimination of trade barriers by the EPU in Western Europe empowered West Germany to continue liberalization policies and further integration into the European and international economic systems. Also, the EPU operated to create “convertibility between members on current account.”<sup>157</sup> The ability of West Germany to cooperate with complete convertibility of the current account—the creation of interoperability between one country’s imports versus another’s exports—created the true barrier lift necessary for the Deutschmark to continue.

After initial reforms, growth in West Germany transformed its economy. Germany became a production success, and the beginnings of its export-oriented nature began to rise in the 1950s. The success of West Germany’s economy was captured in its unemployment rates recorded from 1950 to 1958. The unemployment rate in 1950 was a staggering 11 percent and fell to a 3.7 percent by 1958.<sup>158</sup> Furthermore, the sharp decline in jobless citizens in West Germany was “particularly remarkable given that the German

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<sup>154</sup> Ibid.

<sup>155</sup> Henry H. Schloss, “The European Payments Union,” *Southern Economic Journal*, vol 17, no. 4, April 1951, 465.

<sup>156</sup> Braun, *German Economy in the Twentieth Century*, 179.

<sup>157</sup> Schloss, “The European Payments Union,” 465.

<sup>158</sup> Kerber and Hartig, “The Rise and Fall of the German Miracle,” 340.



labor market had to absorb 9,000,000 refugees from the former German territories.”<sup>159</sup> Germany experienced a shift in paradigm from one of accruing debt to one of issuing credit.<sup>160</sup>

The internal workings of West Germany in the 1950s revealed the need for more workers in an increasingly productive society. So many workers were needed that “By 1956 Chancellor Adenauer was in Rome, offering free transport to any Italian laborer who would make the journey to Germany and seeking official Italian cooperation to funnel unemployed southerners across the Alps.”<sup>161</sup> Although more in tune with its neighbors and ally in the West, the United States, West German capitalism grew to be something quite different than the former’s. It was not that West Germany sought an unliberalized market economy, but rather that “attention to arrangements aimed at preventing or mitigating social conflict, notably between employers and workers” formed the foundation for West German economic success.<sup>162</sup> The memory of Weimar Germany’s economic collapse lingered with both post war West German citizens and politicians alike. The memory of not so distant scares of inflation and strikes formed the economic policies of the German social market. In turn, the focus on preventing inflation and worker strikes created a firm base for economic progress to begin— the strong economic policies geared toward protecting the workers and the state encouraged solid growth.<sup>163</sup>

### **3. Reform as a Function of West German Economic Success and Decline**

The relative economic success witnessed in West Germany produced substantial increases in standards of living for retired and disabled workers. In 1957, pension

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159 Ibid.

160 Ibid., 349.

161 Tony Judt, “The Age of Affluence,” in *Postwar: A History of Europe Since 1945* (New York:Penguin Books, 2005), 334.

162 Ibid., 329.

163 Ibid.

reformed aimed to secure the standard of living for retired citizens.<sup>164</sup> The reform intended to equally raise pensions as time advanced so that an equitable standard of living could be achieved, and that a retired worker would not be left behind economically. The labor force achieved reforms in disability policy as well. As long as a worker attempted to rehabilitate “through medical or other interventions,” he received permanent disability benefits.”<sup>165</sup> Disability benefits applied to blue and white-collar workers alike, and accounted for a worker’s training in a specific field so that a worker was not forced into an ad hoc, or undesirable, occupation.<sup>166</sup>

Inevitably, a bust period followed the boom of the ‘economic success,’ and certain insurances ensued. For instance, in the strong period of the 1950s and early 1960s, West Germany managed to maintain high levels of employment with only 0.7 percent without work, but those levels soon decreased.<sup>167</sup> As the call for workers declined, and in remembrance of the bust period of the Weimar Republic in the 1930s, the German government created the Labour Promotion Law in 1969.<sup>168</sup> The law sharply resembled characteristics of the West German social market since its aim “was to re-integrate the worker into the labour market on the basis of standard employment relationship.”<sup>169</sup> The law harkened back to Polanyi’s ‘double movement,’ because it recognized the dissonance between the working environment’s technological advances and the individual employee. Simply, if an employee found himself without work, the law recognized that the technology merely out-paced the worker, and created an environment that left the worker behind.<sup>170</sup>

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<sup>164</sup> Peter Bleses and Martin Seelib-Kaiser, *Dual Transformation of the German Welfare State* (Gordonsville: Palgrave Macmillan, 2004), 19.

<sup>165</sup> Ibid., 20.

<sup>166</sup> Ibid.

<sup>167</sup> Ibid., 22.

<sup>168</sup> Ibid. 21–22.

<sup>169</sup> Ibid., 22.

<sup>170</sup> Ibid.

Lastly, stemming from the inherent dangerous environment created in the shipbuilding industry, the West German government made employers grant sickness insurance.<sup>171</sup> The law required “employers to pay 100 per cent of a worker’s prior earnings during the first six weeks of his sickness.”<sup>172</sup> Again, this law aimed to guarantee the standard of living that the worker deserved while he could not work. In sum, the laws created in the early years of the West German social market protected workers in ways not previously envisioned. Certainly, a premium was placed on workers that highlighted the growing importance of labor in its relationship with industry and government.

### **C. EARLY GERMAN ECONOMIC SUCCESS FOLLOWED BY RECESSION**

In contrast to the German growth of 0.4 percent per year found in the years between 1913–1950, West Germany experienced 6.5 percent in the 1950s.<sup>173</sup> Western Europe experienced increased prosperity in the 1950s as a result of increased international trade and interconnectedness not previously found on such a level. In the 1950s Germany increased its dependence upon its exports and witnessed an increase from “7.3 percent in 1950 to 19.3 percent just 10 years later.”<sup>174</sup> With success came policies of protection geared toward the *Mittelstand*. Deemed the livelihood of the German social market economy, the *Mittelstand* represented the core building blocks of economic and social success. In order to protect this grouping of businesses, “Cheap public credits and tax privileges were extended to finance the establishment of new small and medium sized firms.”<sup>175</sup> During Germany’s time of economic boom in the 1950s, critics claim, fiscal policy did not promote a strong liberalized agenda that could have propelled the country’s success further.

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<sup>171</sup> Ibid.

<sup>172</sup> Ibid.

<sup>173</sup> Judt, “The Age of Affluence,” in *Postwar: A History of Europe Since 1945*, 325.

<sup>174</sup> Ibid., 326.

<sup>175</sup> Braun, *German Economy in the Twentieth Century*, 180–181.

In the late 1950s and early 1960s, West German productivity declined.<sup>176</sup> Economic liberals sought an independent Central Bank (*Bundesbank*), but politicians were staunch in their support of a bank that pursued monetary stability.<sup>177</sup> Essentially, the economic boom could not be exploited to its full potential, and the 1960s incurred a declining economic situation. The West German *modus operandi* to pursue high levels of exports garnered international attention and speculation. Created in 1963, the Council of Economic Experts recommended “the introduction of flexible exchange rates to stop imported inflation.”<sup>178</sup> The speculation mounted from a declining United States dollar, and increased government intervention appeared necessary.<sup>179</sup> Having reached its business cycle peak by 1963, international demand decreased and the need to constrict federal expenditure increased.<sup>180</sup> Although relatively minor, this West German boom and bust period formed much of West German economic policy in the following decades. Finally appreciating the effects of over-expenditure, government financed programs met their end.<sup>181</sup>

Streeck agreed that “From the mid-1970s on, the postwar interventionist state of Germany was under strong and apparently irresistible pressures for fiscal overextension which emanated mainly from rapidly rising spending on social security, including active and passive labor market policy.”<sup>182</sup> The final years of the 1960s set the stage for Streeck’s prognosis. Modeled after Keynesian economics and strong government intervention, the well-known Minister of Economics Karl Schiller insisted upon the interlinking of federal and municipal budgets. His initiative aimed to determine, in advance, cyclical periods that would necessitate government intervention.<sup>183</sup> In order to

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176 Ibid., 181.

177 Ibid.

178 Ibid., 182.

179 Ibid., 181–182.

180 Ibid., 182.

181 Ibid.

182 Wolfgang Streeck, *Re-Forming Capitalism: Institutional Change in the German Political Economy* (Oxford: Oxford University Press, 2008), 94.

183 Ibid., 183.

achieve this end, “A council for anticyclical policy (*Konjunkturrat*) was established consisting of representatives of the Federal, state and municipal governments and of the *Bundesbank*.<sup>184</sup> Schiller “did not believe in complete competition,” and wanted a distinction between macro and micro decision processes.<sup>185</sup> The macro level managed the “aggregates like investment, income or consumption.”<sup>186</sup> On the micro level, Schiller intended for it to manage the price mechanism so that competition remained intact—thus forming the unique blend of government intervention in a competitive market found in the West German social market.<sup>187</sup>

Schiller faced a fluid period in the 1970s, marked by exogenous causes of inflation from the oil shock of 1973. Schiller’s creation of macro-economic control by the state proved unreliable due to the government’s inability to accurately predict trends. After an initial period of boom, trouble lurked. The government’s action to curb inflation produced a counterproductive outcome, and “The German Central Bank was in a dilemma: in order to fight inflation the interest rate had to be kept high. This, however, attracted foreign exchange inflows.”<sup>188</sup> Furthermore, after battling unemployment and inflation, Schiller was replaced by Helmut Schmidt in 1972.<sup>189</sup> Schmidt attempted to take charge of the situation through restrictive policies and monetary stabilization.<sup>190</sup> Unknowingly, the policies set forth by Kohl only exacerbated the declining economy, and “procyclical public expenditure, high wage settlements first in public sector, then in private sector, a restrictive monetary policy and the government’s hesitation to revalue the *Deutsche Mark* because of export interests,” appeared to be the culprits.<sup>191</sup> For business, this meant that wages and raw materials were too high for them to proceed and remain competitive, which was in part due to the “oil crises in 1973 and 1979 [that]

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184 Ibid.

185 Ibid., 184.

186 Ibid.

187 Ibid.

188 Ibid., 185.

189 Ibid.

190 Ibid., 186.

191 Ibid.

brought about an additional rise in production costs.<sup>192</sup> The dilemma resulted in a downswing of the economy.

The economic policies of the late 1970s reversed the anticyclical policies created in the early part of the decade. To stop unemployment, the German government reevaluated its policy and created mechanisms to promote investment. Therefore, for private investment to occur, and the ensuing hiring of employees, taxes and interest rates associated had to be lowered. This particular time in German economics was not entirely unique and similar policies of liberalization could be found in other Western countries, such as the United States and the United Kingdom with President Ronald Reagan and Prime Minister Margaret Thatcher. Nevertheless, international occurrences warranted another look at anticyclical policy, but not in the explicit terms created a decade earlier. With a strong dollar that created high prices on imports and high interest rates, “The Federal government pursued a policy of budget consolidation.”<sup>193</sup>

On the flip side from this push toward more liberal markets and economic policies, in 1976, the West German worker enjoyed a seat at the table through political reform, and earned “parity of representation with shareholders on the supervisory boards of large companies.”<sup>194</sup> Although workers earned an added say, 1979 through the early 1980s unemployment spiked in 1982 at two million.<sup>195</sup> Perhaps a more severe sign of West German economic woe, West Germany regressed in its export power.<sup>196</sup>

‘Operation 82’ formed much of West German economic policy in the early 1980s. The reform cut many benefits allotted to family allowances and employment benefits. ‘Operation 82’ certainly removed the individual in West German society from the strong benefits it once enjoyed in order to correct government over-expenditure. After a Christian Democrat and Free Democratic Party (FDP) coalition formed, policy of

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192 Kerber and Hartig, “The Rise and Fall of the German Miracle,” 346.

193 Streeck, *Re-Forming Capitalism: Institutional Change in the German Political Economy*, 188.

194 Wasserstein, *Barbarism and Civilization*, 648.

195 Ibid., 648.

196 Ibid.

liberalization followed aimed at enhancing economic growth. The goal of the coalition government was to create labor market flexibility by breaking down the barriers put in place by strong government programs.<sup>197</sup> Helmut Kohl came to the West German Chancellorship as a result of the change in parliamentary makeup. The general thought during the 1980s in German government became a turn away from Keynesian economics, and was evident in the FDP, “which favoured even more far-reaching cuts in government expenditure.”<sup>198</sup> Kerber and Hartig argued that, “By extending the thick net of labor regulations in the 60s and 70s, German labor markets lost much of their flexibility,” in later years.<sup>199</sup> Simply, the strict regulations previously put in place inhibited the West German social market from taking strides toward large-scale success. Arguably and admittedly without volatility, it is because of these restrictions that the West German labor market can continue to function within relative predictive bounds. The West German economy in the 1980s embodied liberalized reform and achieved modest economic growth of 1.9 on average throughout the decade, but failed to account for the diverse nature of unemployment.

The period of German unification, once the Berlin Wall fell in 1989, introduced a new set of problems that were perhaps conceptualized but never practiced in past economic struggles. The economic differences between East and West Germany were vast and particularly interesting due to the extreme proximity in the two contrasting systems. When the Soviet Union relinquished control of East Germany, and Chancellor Kohl found himself in charge of a larger nation, the West German government had to integrate a similar people with a wholly different socio-economic mindset. Although West Germany practiced elements of government control, its methods never came close to the level of centralized control experienced in East Germany. Another factor to battle was the differing currencies, which Kohl ultimately matched in value through the creation of the Retenmark and its dissolution. Lastly, and less tangible, was the problem of employing a newly introduced society. The problems of unification could have spelled

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197 Ibid., 189–190.

198 Ibid., 649.

199 Kerber and Hartig, “The Rise and Fall of the German Miracle,” 347.

disaster, but did not. Therefore, although this period of time is an essential element of German history, its story only highlights the creativity and endurance of the West German economic system, and more importantly its ability to absorb an exogenous shock that migrated into an endogenous one. The years that followed unification provide an essential snapshot of how Germany managed to use its newly acquired resources as well as assimilate them into its unique form of capitalism.



## V. GERMANY'S REGIONAL ECONOMIC DOMINANCE AND ITS ROLE IN THE EURO AREA

As early as 1996 discussions surrounding unified Germany's place as a world economic powerhouse emerged. Studies revealed that Germany's export domination within the EU grew from the 1970s, through the 1980s, and landed the country at the economic center of Europe in the 1990s.<sup>200</sup> In sum, the gains Germany accrued during this period outweighed its economic partners in most ways, in both absolute and relative terms.<sup>201</sup> By 1992, Germany doubled its market share of exports to fellow EU members, France and Italy, in comparison to statistics from 1958.<sup>202</sup> The period leading up to and entering the age of the Euro as a currency appeared bright and full of potential. With the Cold War over and liberalized trade in new markets made available, growth in the EU appeared possible in exponential ways. Certain obstacles had to be overcome, but Germany managed to find ways to succeed economically and politically. In fact, Michael Mertes attributed the initial success of the EU to Helmut Kohl, proclaiming, "The EMU would undoubtedly not exist today—and the eastward enlargement of the EU would probably not have been forthcoming—without Kohl's strong personal commitment."<sup>203</sup>

The commitments made by the signatories of the Maastricht Treaty bound together the newly created members of the EU in ways not experienced in modern history. The implications of bridging the many ethnic, language, and cultural gaps within the European continent contained particular political and economic ramifications. From the Maastricht Treaty came the formation of the European Union with the Treaty of the European Union, this bound the members together in matters of community and security

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200 Andrei S. Markovits, Simon Reich, and Frank Westermann, "Germany: Hegemonic Power and Economic Gain," *Review of International Political Economy*, vol 3, no 4, Winter 1996, 703.

201 Ibid., 702.

202 Ibid., 704.

203 Michael Mertes, "Helmut Kohl's Legacy for Germany," *The Washington Quarterly*, vol 25, no 4, Autumn 2002, 69.

policy.<sup>204</sup> The EU set the stage for the European Monetary Union to take form and unite members in a common market and currency.<sup>205</sup> Martin Feldstein wrote, “Its significance would not just be the substituting of a single European currency for the individual national currencies of the member countries, but that doing so could lead, as many of its proponents hope, to a political union that would fundamentally change the politics of Europe and of the world.”<sup>206</sup> Writing as the common currency was coming to fruition, Feldstein reflected upon the socio-political importance of a country’s currency and that its existence is the hallmark of a well-established country.<sup>207</sup> More importantly, the leap from individual sovereign currencies to a single shared European currency contained significant psychological ramifications.<sup>208</sup> Alternatively, if one remembers the socio-economic toll of both World Wars, it is easy to agree with Kohl that “the greater political cohesion that would follow EMU is the best way to prevent the recurrence of war in Europe.”<sup>209</sup>

Despite the euphoria of situating the European economic powers in one common union, some policy makers and scholars maintained reservations with the perceived benefits of the Euro area. In 2008, Kenneth Dyson highlighted three specific risks associated with the Euro area. First, is the Euro area in a position capable of fostering stability? Second, was the enactment of the Euro area sustainable? Lastly, was the Euro area formed in haste, and should it have been implemented at a more suitable time? This chapter will make use of Dyson’s questions to establish the German role in the EMU, which is enormous within it: “accounting for 27.5 per cent of total Euro Area GDP and

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204 “Treaty of Maastricht on European Union,” Europa: Summaries of EU Legislation, Accessed November 12, 2013, [http://europa.eu/legislation\\_summaries/institutional\\_affairs/treaties/treaties\\_maastricht\\_en.htm](http://europa.eu/legislation_summaries/institutional_affairs/treaties/treaties_maastricht_en.htm).

205 Ibid.

206 Martin Feldstein, “The Political Economy of the European Economic and Monetary Union: Political Sources of an Economic Liability,” (Cambridge: National Bureau of Economic Research, 1997), 2.

207 Ibid., 3.

208 Ibid., 3–4.

209 Ibid., 5.

37.25 per cent of external trade in good in 2006.”<sup>210</sup> Moreover, the case will be made, in congruence with Dyson, that the EU’s performance is directly influenced by German performance, which today is manifested in Chancellor Merkel’s initiatives. The Euro crisis, beginning in 2007, will be the test-bed for this examination since it calls into question all three aspects of Dyson’s analysis.

#### **A. INTRODUCTION TO GERMANY’S ROLE INTO THE EURO CRISIS**

The Euro area crisis has placed a heavy burden upon both weak and strong members of the European Economic and Monetary Union (EMU). This event has revived interest in the role that Germany has taken within the European continent, which has become increasingly more oriented toward economic growth than military power. Germany, with its sound statecraft, essentially orderly finances and merchant state mentality adapted to the present has benefited from the epoch since 1990 and the onset of globalization, and also more or less from a statecraft that assigns military power a subordinate role and in which collective security and collective defense are best addressed by what some call “civilian power,” a formulation that embodies contemporary ideas about statecraft that reside in society and economy and less so in the products of arms makers and generals in general staffs. Germany continues to be considered the strongest member of the common Euro currency, and because of this it has great leverage among its fellow members.

If Germany is to be considered the political-economic center of the EMU, the key to this role lies in Germany’s economic past and the institutions and practices that have grown from this experience. From the rise of the modern German economy in the middle of the 19th century with its particular form of capitalism and society, Germans have understood money, the market and society in terms far different from the Anglo Saxon capitalism found in the United States. Today, German Chancellor Angela Merkel, along with the leading members of her cabinet expresses much of what Germany’s economic history has taught her. Although Chancellor Merkel places emphasis on competition, her

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<sup>210</sup> Kenneth Dyson, *Euro at Ten: Europeanization, Power and Convergence* (Oxford: Oxford University Press, 2008), 133.

policies carry on social protectionist measures that are at the heart of how the German social market economy developed over the course of the 20th century, as described above.

With Europe's financial crisis, EMU member states have found it difficult to strengthen the bonds of the union. Furthermore, the relevance of the overarching European Union is at stake as well. Since the presence of the Soviet Union provided the impetus for the European countries to create a common market, the lack of Soviet presence today provides little reason to proliferate the common market. The continued growth and development of the EU, with a common currency, was due to "prosperous economic conditions."<sup>211</sup> With the European economic crisis the continuance of the common currency and the EU is in question.

## **B. THE GERMAN SOCIAL MARKET THROUGH THE EUROPEAN FINANCIAL CRISIS**

Niall Ferguson quipped, "Is Angela Merkel, the German chancellor, a female reincarnation of the 'deutsche Michel?'"<sup>212</sup> By this, Ferguson alluded to the scrupulous spending habits of the Germans as an effect of the Eurozone crisis. When the Eurozone financial crisis hit, Germany was in a far different situation than many of its European counterparts. Germany's Finance Minister Peer Steinbrück was quoted in the *International Herald Tribune* in 2007 having said that, "the German economy has weathered the [E]uro's strength in a remarkable way."<sup>213</sup> France and Germany continue to make up the two largest economies of Europe, "with their respective GDP 2009 standing at euro2,400 billion and euro1,950 billion according to EU statistics, [which] represents almost half of the [E]urozone's GDP of some euro9,000 billion."<sup>214</sup> As early

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<sup>211</sup> Sebastian Rosato, "Europe's Troubles: Politics and the States of the European Project," *International Security*, vol 35, no. 4, Spring 2011, 73.

<sup>212</sup> Niall Ferguson, "Merkel's 'deutsche Michel' ploy is bad economics," *Financial Times*, July 11, 2013.

<sup>213</sup> Katrin Bennhold and Stephen Castle, "EU talking tougher about weak dollar," *The International Herald Tribune*, December 5, 2007.

<sup>214</sup> Juergen Baetz, "Merkel, Sarkozy discussing the economy," *Associated Press International*, June 14, 2010.

as 2007, the European market witnessed currency issues, but had trouble pinpointing the cause. Fingers pointed at an undervalued Yuan in China and the then growing United States financial crisis.<sup>215</sup> It is possible that these issues contributed to the European crisis, but they do not represent the sole cause. Nonetheless, European “concern [was] growing that Europe [was] paying the price for problems created elsewhere.”<sup>216</sup>

As trouble mounted outside of Europe, EU officials sought measures to protect their relatively new common currency market within Europe. Germany stood not as an isolated nation, but one with different circumstances that onlookers viewed as advantageous. In late 2007 and early 2008 Europeans looked toward the United States sub-prime mortgage crisis with disdain, but “around 60% of its exports [were] destined for other European about and, within that, more than 40% to the [E]urozone, with only 10% to the U.S.”<sup>217</sup> Simply, with so little enroute to the United States market, Germany was setup to circumvent the financial crisis. In fact, officials, to include Peer Steinbrueck, believed that an overreaction in the German market was possible, and that the U.S. crisis should not be overstated. Moreover, “Steinbrueck said that the impact of the global turbulence in the financial markets on the German economy and, therefore, the current federal budget had been ‘tolerable’ until now.”<sup>218</sup> Although the crisis was not fully realized, poor conditions in the housing market loomed and potential buyers found it difficult to borrow against their credit.<sup>219</sup> It is debatable that the sentiment in Germany, during the early months of the financial crisis, was one of disbelief and hubris. Perhaps, Steinbrueck was one of the few German officials to recognize the impending financial situation in 2008, since he “has managed to bring Germany’s finances under control by curbing spending to reduce the budget deficit to less than 3 percent of gross domestic

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215 Stephen Castle, “Europeans urge China to change rate policy,” *The International Herald Tribune*, October 10, 2007.

216 Ibid.

217 Karina Robinson, “Germany’s Britain-baiting Anglophile – Peer Steinbrueck, Germany’s Finance Minister, Defends His Country’s Positions – And Cannot Resist A Dig At The UK Leadership.” Interview By Karina Robinson,” *The Banker*, January 1, 2008.

218 “German minister warns against hysterical reaction to current financial crisis,” *BBC Monitoring Europe – Political*, February 16, 2008.

219 “Europe still in grips of crisis,” *The Advertiser*, April 7, 2008.

product, in line with EU rules.”<sup>220</sup> Although the idea of austerity, in line with Steinbrueck’s achievements, was not new in Germany, its adherence would become a sticking point in future EMU discussions.

The narrative remained the same from German Finance Minister Steinbrueck that the United States was the cause of the worldwide financial crisis. Moreover, the finance minister argued, “[Germany’s] banking system is more robust thanks to its large co-operative and savings bank sectors, which have been barely affected by the widening turmoil in trans-Atlantic credit markets.”<sup>221</sup> This phenomenon explains the reluctance of not only Germany but also France to deny proposed European Union led bailouts. With the two leading economies, what were the benefits of supplying German and French finances as the bulk of European wide aid? In 2009, “The French, and even more so the Germans, [had] been openly sceptical of such a deal from an early stage.”<sup>222</sup>

Mr. Steinbrueck appeared skeptical to perform many functions in the European financial sector that required governmental influence. In essence, the finance minister opposed talks of European Banks implementing artificial remedies to correct any crises. His reluctance was evident in his opposition to proposed stress tests that EU banks were to impose to gather a better understanding of their banking system’s limits. Steinbrueck posited that such a test would create an unnecessary strain upon the financial system that could ultimately trigger an artificial crisis. Furthermore, distrust in the banking system would grow and future investments would be negatively affected. The overt reluctance to meddle in the financial stability of the overall European Union’s economy appeared to be a staple in Mr. Steinbrueck’s rhetoric.<sup>223</sup>

As the financial crisis took root, in 2010, sentiment in German economic politics was one of skepticism in individual failing nations. The EU banking system was suspect

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220 Judy Dempsey, “Election overtakes German economic overhaul,” *The International Herald Tribune*, April 21, 2008.

221 Marcus Walker, Joellen Perry, and David Gauthier-Villars, “Germany, France disagree on bailout strategy; German Finance Minister says region’s problems less severe than in U.S.; conflicting views could deepen rift in 27-nation EU,” *The Globe and Mail*, October 2, 2008.

222 “A common partnership; Leading Article,” *The Independent*, March 20, 2009.

223 “German minister warns of stress tests for EU banks,” *BBC Monitoring Europe*, May 14, 2009.

as well, but most blame could be found in countries such as Greece. In early 2010 the EU wrestled with the idea of implementing an International Monetary Fund (IMF) type organization within the EU. In creating such an organization, the EU intended to bail out failing countries through a common fund and service supported by the EU. German skepticism remained and, German “Spokesman Michael Offer told reporters that a European equivalent to the International Monetary Fund, as has been floated in the German media, ‘does not appear to be the solution’ to a problem such as that plaguing Greece, because it does not get to the ‘root’ of the problem.’”<sup>224</sup>

Talks of bailouts took root in 2010 and persist today. At the center of the debate was Greece, but other countries such as Cyprus, Spain, and Ireland faced a similar fate. The German government, headed by Angela Merkel, continued to express dismay in talks of bailouts aimed at ailing EU countries. Instead of accepting bailouts, according to Merkel, countries such as Greece must put in place austerity programs.<sup>225</sup> Again, the root of the problem had to be addressed instead of applying a quick solution. Merkel’s finance minister Wolfgang Shaeuble, in 2010, called for similar tactics. A country spending beyond its means was not an option in the eyes of German policy makers any longer. The debate followed in form with the debate between Hayek and Keynes, whereby the German policy makers insisted on decreased levels of spending by government as well as little artificial stimulus provided by the EMU.

With “Germany, Europe’s largest economy, providing the largest chunk of a (EURO) 110 billion bailout for Greece,” it was understandable for Merkel’s government to oppose bailouts for Greece.<sup>226</sup> It should be noted that those countries of the EU that operate under a common currency, the Euro, the Stability and Growth Pact was put in place to establish rules and guidelines. Whether the Pact is effective is debatable, but

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<sup>224</sup> Melissa Eddy, “Germany rejects European fund for Greece,” *The Associated Press*, February 15, 2010.

<sup>225</sup> Juergen Baetz, “Germany’s Merkel: Greece needs to implement plan,” *Associate Press Financial Wire*, March 1, 2010.

<sup>226</sup> Aoife White, “Germany pushes for deficit cuts as euro slides,” *Associated Press Financial Wire*, May 17, 2010.

critics argue that it “called for heavy fines for violators but the EU never imposed them.”<sup>227</sup>

The Stability and Growth Pact is made up of two arms, the preventative arm and the corrective arm. Guided by the medium-term budgetary objective (MTO), “Member states outline their medium-term budgetary plans in stability and convergence programmes (SCP), which are submitted and assessed annually in the context of multilateral fiscal surveillance under the European Semester.”<sup>228</sup> While the preventative arm is focused on keeping EU members out of fiscal trouble, the corrective arm has the authority to impose sanctions and regulations on delinquent members. If a member state violates either, or both, guidelines that direct that “deficit must not exceed 3% of GDP and public debt must not exceed 60% of GDP (or diminish sufficiently toward the 60%) defined in the Treaty on the Functioning of the EU,” the Excessive Debt Procedure (EDP) can be enacted.<sup>229</sup> With Greece and other countries in violation, Chancellor Merkel “wanted bigger legal changes, such as stricter limits on debt and deficits and the ultimate threat of kicking a country out of the [E]uro if it can’t stick to the rules.”<sup>230</sup>

The Greek example highlighted fundamental flaws in EU policy and regulation. In sum, Greece defied the Stability and Growth Pact, and the EU did poorly to enforce the regulations found within. In 2009, “Greece’s newly elected Socialist government revised the estimate for that year’s budget deficit from 6.7 percent of GDP to a whopping 12.7 percent of GDP, and then further revised to above 15 percent.”<sup>231</sup> A senior fellow at the Brookings Institution, Dominico Lombardi, believed the European crisis spiraled from Greek negligence. Like Greece, other European countries, such as Italy, Spain, and Ireland, necessitated bailouts and revised budget plans. The crises of individual states

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<sup>227</sup> Ibid.

<sup>228</sup> Economic and Financial Affairs, European Commission, Accessed November 5, 2013, [http://ec.europa.eu/economy\\_finance/economic\\_governance/sgp/index\\_en.htm](http://ec.europa.eu/economy_finance/economic_governance/sgp/index_en.htm).

<sup>229</sup> Ibid.

<sup>230</sup> White, “Germany pushes for deficit cuts as euro slides,” *Associated Press Financial Wire*.

<sup>231</sup> Dominico Lombardi, “Origins, Options, and Implications of the U.S. and Global Economy,” Senate Banking, Housing and Urban Affairs Subcommittee on Security and International Trade and Finance Hearing on the European Debt and Financial Crisis, September 22, 2011.



were nothing short of having international implications, especially to those sharing borders in the short term. Countries with strong economies, such as France, were affected merely because of a shared a border with floundering economies.<sup>232</sup> As a result, their credit rating declined, which was followed with an increase in bond prices.

In 2010, as the debate continued on how to handle Greece, Germany implemented its own response to deaden the economic crisis within its own borders. Aware of the fiscal rules put forth by the Stability and Growth Pact, Angela Merkel decided that, “Germany can no longer live beyond its means, insisting ‘we can only spend what we take in.’”<sup>233</sup> This sort of fiscal conservatism is typical of the pragmatic German nature expected after decades of boom and bust periods. As the financial situation worsened, the insistence for constraints increased. German calls for European wide austerity measures grew, in 2010, as Merkel’s government proposed “sanctions on countries with high deficits and advocate[d] the path of austerity as a model for Europe after presenting its own package of budget cuts on June 7, worth euro80 billion (\$97) by 2014.”<sup>234</sup> Although France and Germany are the economic giants of the EU, the Sarkozy and Merkel governments did not always see eye-to-eye. Although the two governments have not appreciated fronting the majority of the bailout stimulus packages, the “French government minister in charge of stimulus efforts, Patrick Devedjian...warned that German-style austerity measures ‘would be dangerous because it risks killing growth.’”<sup>235</sup>

As 2010 pressed on, the measures touted by the Germans made their way into the European Central Bank. The German-style austerity measures must not be considered solely Germanic since the same rhetoric can be found in the Stability and Growth Pact. Whether in line with Germany or the Pact, “EU Monetary Affairs Commissioner Olli Rehn said his proposals will call for member states to be punished early for financial

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<sup>232</sup> Ibid.

<sup>233</sup> Geir Moulson, “Germany to unveil cuts to welfare, jobs,” *Associated Press Financial Wire*, June 7, 2010.

<sup>234</sup> Baetz, “Germany’s Merkel: Greece needs to implement plan,” *Associate Press Financial Wire*.

<sup>235</sup> Ibid.

transgressions and insisted sanctions could only be undone by a large majority of member states.”<sup>236</sup> What Angela Merkel considered negligence by Greece now appeared to be a shared sentiment with the European Central Bank, which became a necessary revelation in order to form a more cohesive body with similar fiscal understandings.

Nevertheless, Germany has remained an economic hegemon within the currency union, with France in a close second. As the economic crisis continued it became necessary for the German leadership to apply their fiscal methods upon the Euro area so that unity could be found. In early 2011, Merkel attempted to alter the way in which the EU operated. So that future crises could be recognized and remedied earlier, her plan “entail[ed] more closely harmonizing their financial, economic, and social policies.”<sup>237</sup> Merkel’s aim was to eliminate surprises by finding a common model that all EU members could follow. It is conceivable that as Germany continued to act as the EU’s purse that Angela Merkel wanted a larger say in what happens in EU affairs. In 2011, “Germans worr[ied] that their trusted Bundesbank [was] being taken over by Club Med central bankers who [were] ganging together to soften the euro.”<sup>238</sup>

For the European Union members that use the Euro, a common strategy had to develop. This is difficult to come by, but options are available and “Potentially, the ECB has unlimited financial firepower through its ability to print money. However, Germany finds the idea of monetizing debts unappealing, warning that it lets the more profligate countries off the hook for their bad practices. In addition, it conjures up bad memories of hyperinflation in Germany in the 1920s.”<sup>239</sup> This emotion is inescapable; and for its neighbors to dismiss Germany’s past episodes of inflation is destructive and irresponsible. For Germany, the underlying theme continued to be structural change in

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236 Raf Casert, “Germany backs sanctions for profligate EU nations,” *Associated Press Financial Wire*, September 27, 2010.

237 “Merkel’s Plan Could Transform the European Union,” *Spiegel Online International*, January 31, 2011.

238 “Angela Merkel’s nightmare: the markets test the German Chancellor’s approach of trial-and-error. Is there an end game in sight?,” *The International Economy*, January 2011.

239 Greg Keller, “Germany deflects calls for ECB to have more power,” *The Associate Press*, November 24, 2011.

the EU framework that prevents countries, such as Greece, to engage in poor economic practices. Chancellor Merkel's reluctance toward bailouts and her predilection for austerity appeared to work for Germany. By mid-2011, it was reported that Germany recovered from the financial crisis and "there are now more jobs in the economy than before the crisis."<sup>240</sup> However, with cheers came jeers, and critics worried that Germany's recovery was nothing more than those experienced in France, Sweden, and Switzerland."<sup>241</sup> Moreover, even if Germany claimed to have escaped the financial crisis it must continue to deal with its weaker partners that suffer from massive debt.

The high demand for German products and the increase in jobs did not mask the long-term implications of the European-wide financial crisis. Germany remained reluctant to increase the size of bailouts for its poorer neighbors. It became apparent that the financial crisis was not just European or American, it was worldwide, and German exports were affected. As much of the international market constricted its imports, countries such as Germany, reliant upon their export power, felt the exogenous shock. Therefore, if Germany determined the financial crisis to be an existential threat, how could it continue to back calls for an increase in European bailout projects? It was reported that, "In contrast to France, Berlin has so far ruled out boosting the size of the currency union's bailout fund, the European Financial Stability Facility."<sup>242</sup> Nevertheless, the ESFS's scope was widened in 2011.<sup>243</sup> Created in 2010, the EFSF is backed by the German Debt Office (DMO), and functions to stem the spread of economic contagion through the European countries. Indeed concessions were made, but they have left Germany behind the helm—an aspect that fellow members must understand and deal with.

Support grew in 2012 for a more powerful ECB—one that can perform as a central body overseeing Europe's banks. Obvious institutional differences were at play;

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<sup>240</sup> "Germany's Impressive Recovery Presents Reform Opportunity," *News Press*, July 13, 2011.

<sup>241</sup> Ibid.

<sup>242</sup> Gabriele Steinhauser and Juergen Baetz, "Germany at center of storm as stockmarkets dive," *Associated Press Financial Wire*, August 9, 2011.

<sup>243</sup> Lombardi, "Origins, Options, and Implications of the U.S. and Global Economy."

German Finance Minister Schaeuble rejected the idea of having the ECB control all of German banks, and French Finance Minister Moscovici insisted that all European banks be placed under the ECB's control.<sup>244</sup> Also an item of contention between France and Germany in the financial debate was the use of Eurobonds. Unlike Francois Hollande's government, "Angela Merkel's government remain[ed] staunchly opposed to the idea of jointly issued bonds for the 17-nation [E]urozone."<sup>245</sup> Again, and rightly so, Germany continued to press for measures in austerity instead of an increase in debt. It was clear that Germany believed that if the ECB continued to buy bonds that it would find itself in a financial debacle and unmanageable debt.<sup>246</sup> Merkel's government believed that the onus should be on individual states so that the hemorrhaging of Euro area common funds could stop.

After the Fulbright German Studies Seminar 2012, Thomas O. Haakenson concluded that the Euro area crisis contained two common themes. He explained that they are; "the complexity of decision-making within the EU and the difficulties involved in forming a broadly European identity."<sup>247</sup> These two themes bring into question the aforementioned problem of who owns the individual banks. One could view the Euro banking system as flawed since it relies on a central bank, but requires individual sovereign nations to enact policy decisions.<sup>248</sup> Haakenson detailed valid reasons for Germany's reluctance to pursue an overt posture in taking the Euro area's reigns, but too little did he recognize the already present German model within the EMU construct. Indeed, he reasoned that a history and fear of inflation shape the German financial model, but too easily did he dismiss this as reason for German calls for Euro-wide austerity measures. Haakenson takes issue more with society than economics, and does so with a

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<sup>244</sup> Raf Casert, "Germany, France at odds over EU banking supervisor," *Associated Press Financial Wire*, December 4, 2012.

<sup>245</sup> Juergen Baetz, "Germany staunch in opposition to eurobonds," *Associated Press Financial Wire*, May 22, 2012.

<sup>246</sup> "Germany welcomes ECB promise to secure euro," *Associated Press Financial Wire*, July 27, 2012.

<sup>247</sup> Thomas O. Haakenson, "German Studies and the Euro Crisis," *German Studies Review*, vol 36, no 1, February 2013, 125.

<sup>248</sup> Ibid.

strong understanding of German history, but he prescribed a Germany capable of melding its character to the broader EU. Conversely, he added that the EU could take on very distinctive German features—a result that appears more plausible in the EMU economic scheme where Germany continues to find itself in the middle.

The financial crisis highlighted fundamental differences between sovereign nations, such as when “At Germany’s behest the EU treaties were amended in March 2012 to introduce new fiscal rules for Euro members, known as the ‘fiscal compact.’ Among other things, this required all [E]uro members to amend their constitutions to install a ‘debt-brake.’”<sup>249</sup> Maneuvers such as this have the potential to spread Euro-wide skepticism, but it is more probable that they have exposed elements of cooperation and innovation between the Euro members. Despite the many instances that the EU appeared to be in crisis, it is arguable that “The EU and its members have been trying to do a great deal, and they have been more successful than generally realized.”<sup>250</sup> Through the years of financial crisis, it is clear that Chancellor Merkel consistently desired a strong Euro and healthy EU members. Her insistent push for fiscal conservatism has been measures to secure not only the Euro currency, but to strengthen the European security bond as well.<sup>251</sup>

At the time of writing, Ireland has declared that it is out of recession and that it plans on removing the austerity measures put in place. Whether this makes Germany uneasy or not, the fact remains that the austerity measures backed by Chancellor Merkel not only found footing in the Euro area marketplace, but proved to provide an escape from financial collapse. The austerity measures followed by Ireland included, “tak[ing] €28 billion (\$38 billion) out of the economy in spending cuts and tax rises, which amounts to 17% of today’s GDP.”<sup>252</sup> If Ireland truly exits the bailout it received a mere three years ago in 2010, the austerity measures backed by the German government must

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<sup>249</sup> “Europe’s Reluctant Hegemon,” *The Economist*, June 15, 2013, 7.

<sup>250</sup> Wallace J. Thies, “Is the EU Collapsing?,” *International Studies Review*, vol 14, issue 2, June 2012, 235.

<sup>251</sup> “Germany rejects criticism of euro crisis actions,” *Associated Press Financial Wire*, June 27, 2011.

<sup>252</sup> “The Eighth Austerity Budget,” *The Economist*, October 19, 2013, 56.

be taken in and given ample consideration.<sup>253</sup> Yet, with that Germany must understand that responsible lending in the form of bailouts will continue to be a function of the EMU in the foreseeable future. The two methods could be considered a couple rather than mutually exclusive. Indeed, the bailouts appear to have a positive influence, however, German austerity measures are necessary and the adherence to the Stability and Growth Pact's guidelines prove to be equally as important.

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<sup>253</sup> Ibid.

## VI. CONCLUSION

German economic practices have arisen from the nation's political and social past, and in fact one makes little sense with the other. Had the Treaty of Versailles not placed such a heavy war reparations demand upon Germany, while France annexed much of its industrial and raw material power, the Weimar Republic might have prevented two instances of hyperinflation. In the post war era, West Germany could look upon the Weimar Republic's double bout with inflation and economic disparity, and thus pursue policies driven by measures of protection in order to prevent financial turmoil as the basis of political stability and western integration. In addition, such policies coupled with the Allies' propensity to fuel West German economic prosperity through western integration in the U.S. led system, promoted rather than ravaged, West Germany's ability to grow in the 1950s. West Germany's unification with its eastern brethren in 1990 tested its ability to handle large-scale shocks as well as its economic structure. The same should be said of a united Germany's place in the European Union's economic currency partnership beginning in the late 1990s. How Germany integrates itself into the common currency remains critical to the EU's success as a common market and more, and how the EU handles both exogenous and endogenous shocks could spell out its future. Today, Germany continues to exceed its desire to prop up the Euro currency, but its willingness to do so persists without clear signs of dissipation.

Just as a personal experience is interpreted differently by the affected person than by an onlooker, the way in which Germans view their economic history differs from that of their neighbors and partners from afar. Persons outside Germany with no experience of the past routinely cannot discern cause and effect with much clarity. As a case study to compare the current Euro area crisis, in Weimar Germany's time period, the Allies viewed war reparations placed on Germany as not only a necessity of policy, but something that they deemed would set the record straight and thus made them blind to the more profound macroeconomic costs of such a punitive policy based on past experience in the 18th and 19th centuries. Germans, on the other hand, understood the demands as vengeful, unreasonable, and damaging to markets interconnected with Germany. How

Germans understand their socio-economic position explains much of Germany's economic history as well as the recent and ongoing Euro area economic crisis. In fact, German relations with its floundering Euro partners are indicative of the economic policy borne from tacit knowledge that it places upon itself. Simply, the rules that Germany has placed on itself domestically are precisely what it expects its fellow partners to adhere to as well.

Moreover, the Weimar Republic's short life contained particularly interesting elements for one to understand the financial crisis that started in 2007. As a historical case, for post war Germany to learn from the Weimar Republic made the Allies realize that methods of reinvigorating Germany rather than dismantling it ought to be pursued. The comparison can be extended to Germany today, but with alterations in the roles played in the international political economy. If Germany is compared to the Allies of the post-World War II era, comparisons could be made. For instance, the way in which Germany today stands as the economic strong back of the Euro is comparable to the leverage the Allies had over West Germany after World War II. This point is especially the case in how the Allies attempted to pursue their agenda in West Germany—which in comparison can be said of Germany in the EU. The United States brought forth the Marshall Plan, which set guidelines on how the U.S. would aid the occupied West Germany. Today, by contrast, Germany has not successfully put in place all measures of austerity that it would like to see in failing states of the EU, but its economic power is felt in uncomfortable and disconcerting ways whereby the comparison with the reparations question and the post 1945 western and Euro-Atlantic order form a useful point of comparison. Although such southern European countries as Greece have received bailouts, the terms of such agreements make no sense without an understanding of the Protestant Swabian austerity dicta reminiscent of the Bruening government, but which also arise greatly because of domestic political imperatives of which Chancellor Merkel is deeply aware and can never escape.

In addition, this paper argues that the German economic experience is unique and very different from those of its closest neighbors. Setting the Weimar Republic as the historical benchmark, one could progress through German's history and understand its



nuanced nature as well as its social market concept. The Dawes Plan of 1924, and the modified Young Plan of 1929, attempted to extract what reparations it could from the Weimar Republic through duty free exports to recipients like France and forced German policy makers to meet these demands often at the expense of the German public that was ever more radicalized. Once economic chaos struck again in 1929–30, the Nazi party and its leader Hitler filled the confidence gap that the German people desperately needed with an ideal of full employment at whatever cost, with an abandonment of the world economy and an eventual policy of German economic hegemony. Although short lived and with grand repercussions, the German worker found a job and purpose through feeding Hitler’s artificial economic purpose. This span of time witnessed a strong swing of the pendulum from the Weimar Republic’s floundering under war reparations and economic ambiguity to a strong resurgence in the German government taking ahold of their economic position.

The Third Reich’s collapse left Germany with little economic infrastructure, much to be blamed on the Reich as well as the damage done by the Allies. The splitting of Germany into two after the war created the interesting dynamic of one side propelled by Western capitalist ideals and the other by a structured central government. With proper focus on West Germany, the social market’s creation and future found roots in Germany’s checkered economic past dating back to the end of the Great War. Fear wrote, “The notion of a ‘social market economy’ became central to national stability.”<sup>254</sup> The concept was more or less unique (shared by the Austrians and Scandinavians), but not outlandish when conceptualized in regards to where Germany’s trajectory began and followed. In marrying the economic and social needs of its citizens and its pursuit of a modified capitalist structure, West Germany found its place in the Western system through substantial welfare programs and a propensity for a large savings.<sup>255</sup>

Economic prosperity found a home in West Germany early on, but this was not the case throughout the entire Cold War. Natural boom and bust periods followed, but it

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<sup>254</sup> Fear, “German Capitalism,” 172.

<sup>255</sup> Ibid.

is important to note that the social market economy continued and established itself as the norm in Germany's socio-political-economic construct. The reunification of Germany presented the next major hurdle to overcome, which included the melding of two peoples with distinctly different economic experiences and the swallowing of an entire country by another. Currencies at odds with one another and an enlarged workforce demanded social protections to be reinforced and placed on all citizens from the west and east alike. Ultimately successful, Chancellor Kohl established a unified Germany capable of integrating with the international market, as well as a soon to be common currency within the EU.

#### **A. BROADER IMPLICATIONS AND WHY UNDERSTANDING GERMAN ECONOMIC HISTORY MATTERS**

Much is at stake when negotiating the future of the Euro as a currency and of the European Union as a common space with core ideals. From a macroeconomic perspective, the EU's ability to manage its currency through financial crisis has international implications. The EU's relations with other countries such as, the United States, China, and Russia, are affected by how well the largest currency in Europe performs. Therefore, from this perspective, Germany's role in the EU is of exceptional importance. Its export power alone creates stability and performance oriented growth for the Euro that many other members cannot claim to do. Germany's place as one of the big five countries, as considered by the EU, makes its stability critical to the success of the Union.

Certainly, Germany has not single-handedly cured the financial crisis that hit the Euro area, but its relative economic strength has deadened the pain. In terms of gross debt, Germany continues to maintain between 81.1 percent to 81.9 percent since the first quarter of 2012.<sup>256</sup> This is lower than the Euro area's gross debt during the same period, which maintained between 88.3 percent and 90.7 percent since quarter one of 2012.<sup>257</sup> Since many point their fingers at Greece for perpetuating the sovereign debt crisis, its

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<sup>256</sup> Eurostatistics Data for Short-term Economic Analysis, Issue Number 05/2013 (Luxembourg: Publications of the European Union, 2013), 31.

<sup>257</sup> Ibid., 21.

numbers are relevant. From the first quarter of 2012, Greece maintained 136.5 percent of gross debt and ended 2012 with 156.9 percent.<sup>258</sup> Perhaps more telling is the large disparity between employment numbers in recent quarters. Greece trends toward higher unemployment numbers with a staggering 27.2 percent of its population unemployed in the first month of 2013.<sup>259</sup> Germany, on the other hand, reported 5.4 percent for the same time period, with no more than 0.1 percent variation since May 2012.<sup>260</sup>

The Euro area financial crisis prompted policies makers of the EU and individual countries to rethink economic policies and how they are able to weather shock. Germany was prepared to weather the storm better than other EU members, and its recovery is a testament to this. Moreover, members of the common currency should regard Germany's policies as effective. Alternatively, Germany must understand that what worked for its country might not spell out the same successes in other countries with wholly different socio-economic conditions. Although, the German model does raise the question, and perhaps provides the answer, of whether conditions of austerity and manageable debt should be policy maker's priorities. Moreover, one can look to the solidarity that formed with the American backing of the Dawes Plan as an analogy to the German backing of Euro area led austerity measures and bailouts.

It is no surprise that Germany, specifically Chancellor Merkel, found it difficult to back plans for wide scale bailouts aimed at the failing countries of the common currency. The aforementioned unique economic experience of Germany affects its policy makers today, and its propensity to follow tried and true methods is apparent. Domestic and international shocks alike are not new phenomena for Germany, and the methods put in place through its history are learnt from those experiences. This answers why Germans act in the manner in which they do; it is the historical hardships endured by their ancestors that propel Germans to ask more from their government than in other democracies. A unified communist or completely socialist German state never came to

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<sup>258</sup> Ibid., 37.

<sup>259</sup> Ibid.

<sup>260</sup> Ibid., 31.

fruition. Perhaps because of its ability to produce and manufacture complex and often superior goods or from its desire for competition, Germany's predilection for capitalism remained at its roots. More important than its pursuit of capitalism is its drive for social protection, which finds its purpose in every corner of its modern history. At the expense of its ability to experience volatile market fluctuations is the German method of detail and protection of its most important product, its people. For the Euro area, understanding German methodology is paramount if the EU wants to look at Germany for financial assistance and guidance.

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